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Politics this week

Mar 7th 2002
From The Economist print edition

A hot battle

Reuters

Eight American soldiers died and 40 were wounded in the fiercest battle of the war in **Afghanistan**. About 1,000 Americans, together with Afghan forces, came under heavy fire in their search for al-Qaeda and Taliban fighters in mountains near Gardez. In Kabul, three Danish and two German peacekeepers were killed while dismantling a missile.

See article: The military lessons of Afghanistan

The death toll in Hindu-Muslim clashes in the western Indian state of **Gujarat** rose to more than 600.

See article: Religious violence in India

China's National People's Congress was informed that welfare spending would increase by 28% to combat the effects of unemployment caused by the country's membership of the World Trade Organisation.

See article: China's uncertain future

Senior **North Korean** officials visited the European Union's headquarters in Brussels on a fact-finding mission. They were briefed on the EU's economic, industrial and trade policies. Observers pondered the significance of representatives of the “axis of evil” casting an eye over Europe's efforts at political and economic union.

India's Supreme Court sentenced Arundhati Roy, a prize-winning novelist, to a day in prison for “lowering the court's dignity”. She has been campaigning against huge dam-building schemes in the country.

Tommy Suharto, son of **Indonesia**'s former dictator, was charged with murder.

Violence as usual

Violence of all kinds spiralled in Israel, the West Bank and Gaza claiming the lives of more than 70 Palestinians and over 30 Israelis. Many of the victims, on both sides, were children.

See article: Israelis, Palestinians and vengeance

Although **Syria** gave its backing to Saudi Arabia's call for all Arab countries to normalise ties with Israel if it returned to its 1967 borders, it clouded the issue by insisting that the plan also guaranteed the right of return of Palestinian refugees.

Iran's reformist parliament approved the outline of a bill banning the use of physical and psychological torture to gain information from detainees. The bill still faces many hurdles.

Reuters

As **Zimbabwe** prepared for its presidential election this weekend, the opposition contested in court Robert Mugabe's bid to reintroduce restrictive

legislative laws that the Supreme Court had thrown out last week. Commonwealth leaders, meeting in Australia, decided to delay a decision on Zimbabwe's suspension from the organisation until after the election.

See article: Zimbabwe's presidential election

The stalled peace talks between **Congo's** internal warring factions resumed in the South African resort of Sun City after a compromise was reached on the size of delegations. None of the foreign armies still in Congo is represented at the talks.

African mediators flew to **Madagascar** to try to end the stand-off between the incumbent president and the new self-declared one. The country now has two governments and two capitals.

See article: Madagascar's two presidents

The price of victory

For the first time, prominent Democrats in Congress raised questions about the conduct of the United States'**war on terror**. Republicans attacked them for their lack of patriotism. Meanwhile, to the fury of the Democrats, the new homeland-security chief, Tom Ridge, refused to appear before Congress to explain his $38 billion budget in the next fiscal year. Mr Ridge maintained that he was an adviser to the president rather than a cabinet officer answerable to Congress.

See article: Questions about the war

California's Republican primary was won by Bill Simon, a conservative newcomer to politics who comfortably beat Richard Riordan, a former mayor of Los Angeles.

See article: The Republican primary in California

There was enough evidence to press criminal charges against **Bill Clinton** over his lies about his relations with Monica Lewinsky, according to a report by Robert Ray, an independent counsel. But, on his penultimate day in office, Mr Clinton's lawyers cut a deal to spare him from criminal prosecution—with Mr Ray.

Swiss join the world

The **Swiss** agreed in a referendum to join the United Nations. Doubters worried that Switzerland's famed neutrality might be compromised.

See article: Switzerland says Yes to the UN

Boris Berezovsky, one of **Russia's** richest men, who is in exile because of fraud charges he faces back home, accused the Russian security services of blowing up blocks of flats in Moscow and elsewhere in 1999. He claimed that the bombings were a pretext for the prime minister of the day, Vladimir Putin, now Russia's president, to relaunch an election-winning war against rebel Chechnya.

Reuters

The **Mont Blanc tunnel**, linking France and Italy, was set to reopen nearly three years after a fire killed 39 people.

Kosovo's legislative assembly elected Ibrahim Rugova as president after a deal had been struck between rival ethnic-Albanian parties to share power in the UN-administered province.

See article: Paddy Ashdown goes to the Balkans

Macedonian police killed seven men accused by the authorities of planning a terrorist attack on the American and other western embassies in the capital, Skopje. Five of the dead were said to come from

Pakistan or the Middle East.

Argentina cuts back

In **Argentina**, President Eduardo Duhalde won a breathing-space: Congress approved a budget with cuts of 14% over last year's spending and provincial governors agreed on a temporary cut in revenue transfers. But the measures seemed unlikely to impress an IMF mission that arrived in Buenos Aires to start talks on a new loan agreement.

See article: Argentina talks to the IMF

Roberto Madrazo, a former state governor of flexible views, was proclaimed the winner of an election for the presidency of **Mexico's** Institutional Revolutionary Party, the largest opposition party. The election was marked by claims of fraud.

In **Colombia**, a senator was murdered days before a congressional election. Police blamed her killing on the FARC guerrillas. Meanwhile, the American State Department reported that Colombia's human-rights record remained “poor” and that the army officers continued to collaborate with right-wing paramilitaries.

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Business this week

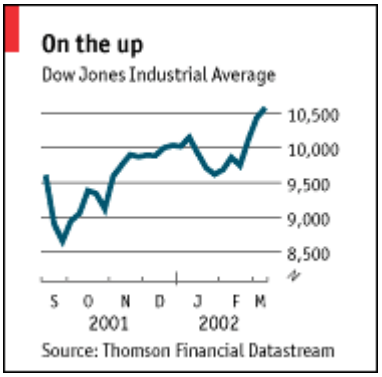
Mar 7th 2002
From The Economist print edition

Steely in March

The United States whacked tariffs of up to 30% for three years on most **steel imports** from many of the world's biggest producers,who greeted the move with outrage. America was accused of setting back the cause of free trade; the EU promised an immediate complaint to the WTO; and commentators predicted a trade war. America insisted that its action was warranted and necessary.

See article: Steel and America's trade sanctions

America's stockmarkets perked up after recent signs of economic recovery. The Dow Jones Industrial Average rose several percentage points to hit its highest level for some months before slipping back. The tech-heavy Nasdaq also made useful gains.



See article: Stockmarkets turn bullish

America's car makers saw sales slip by 3.5% in February compared with a year ago. However, expectations were exceeded, partly because the economy is picking up and certainly because of a 0% finance deal. General Motors was happiest; sales improved a modest 0.4% while Ford and DaimlerChrysler both saw drops of 11%.

See article: The problems of GM and Fiat

On the surface, things look bad for **Formica**. The plastic-laminate company filed for Chapter 11 bankruptcy protection to allow time to wipe clean its debt problems. It is unlikely to repeat its success of yesteryear when plastic-clad interiors were considered the height of good taste.

Divorced mother of four Suzy Wetlaufer, 42, was urged by colleagues to resign from the editorship of the highly-regarded ***Harvard Business Review*** after it emerged that an interview she had conducted with "Neutron" Jack Welch, 66, had become overly in-depth, leading to a romantic entanglement. The article did not appear in print; Miss Wetlaufer admitted that she had got "too close" to her subject.

Called to account

Stung by the Enron scandal, President George Bush drew up a far-reaching plan to extend **regulation of the accounting industry** and toughen up the penalties for wrongdoing. Among the proposals: CEOs will have to swear by their financial statements each quarter.

Andersen's tribulations showed no sign of abating. The deeply wounded accountants agreed to pay $217m to settle litigation resulting from an audit of Baptist Foundation of Arizona, a non-profit investment fund that collapsed in 1999; it operated like a pyramid scheme under Andersen's nose. Andersen admitted no culpability.

Freddie Mac, America's mortgage-guarantee agency, gave Andersen the chop as its auditor. **Merck** praised Andersen for its "excellent auditing services"; unfortunately in an announcement that the drug giant would also dismiss the troubled bean counter.

Bad news in the media

Pearson made a pre-tax loss of £438m ($631m) last year compared with profits of £284m the year before. But assurances that profits would grow handily this year as its education businesses blossom sent its shares shooting up. Or perhaps investors think that things can only get better.

RTL, a European broadcaster controlled by Germany's Bertelsmann, said that losses for 2001 would be *euro*2.5 billion ($2.2 billion) after a whopping write off of *euro*2.3 billion on Fremantle Media, a production company responsible for Baywatch among other delights.

Vivendi Universal paid for its buying spree. The French media giant wrote off *euro*15.7 billion ($13.7 billion) after the value of the assets it acquired in recent years fell dramatically. Vivendi reported a loss of *euro*13.6 billion for the year.

Oracle's future woes

Oracle saw its share price founder after it warned that profits for the past quarter would not match up to expectations. The company blamed a sales slowdown in Asia, which a slight rise in Europe and America failed to offset.

Hewlett-Packard's long-running bid for Compaq Computer received a boost from Institutional Shareholder Services, a group advising some 23% of HP shareholders. ISS recommended voting for the merger, ensuring a close contest when investors give their verdict on March 19th.

See article: How HP-Compaq hope to make their marriage work

A war of words between **Celera Genomics** and the publicly funded **Human Genome Project** continued. A research paper by HGP came close to accusing Celera of cheating on the assembly of its version of the human genome, published a year ago. Celera mounted a vigorous denial, pointing out numerous errors in the paper.

Britain's **Imperial Tobacco** bought Germany's **Reemtsma**, the world's fourth-largest cigarette maker, for *euro*5.8 billion ($5.1 billion) to become a king-size company capable of competing with smoking's big three: Philip Morris, BAT and Japan Tobacco.

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The war on terror

Six months on

Mar 7th 2002
From The Economist print edition

A balance-sheet

AP

WHEN Osama bin Laden's al-Qaeda terrorists felled New York's twin towers, commentators said that September 11th would alter the course of history. So it has. The most visible change has come in Afghanistan, but the foremost change has come in America itself. Since September, Americans have thought differently about their vulnerability, their power and the need to use that power in faraway places in order to feel safe at home. Because America has changed, the world has changed too. In Europe, in Russia, in the Islamic world and beyond, governments have had to weigh George Bush's challenge to be either with or against America against terrorism. It is still too early to be sure what that challenge will eventually entail, still less how the world will respond. This war is far from over. But it is time for an interim audit.

Any balance-sheet must start by recording two big American successes. One is a positive success: military victory in Afghanistan. The other is a negative success: in striking back against terrorism, Mr Bush has avoided the mistake of taking actions that risk turning many more hearts, minds and governments needlessly against America. Despite his “axis of evil” speech, he has matched forcefulness in Afghanistan with an unexpected delicacy in statecraft. But a careful auditor would note that neither of these two big successes is completely secure. Without due care, both could tip into failure.

What went right

America removed Afghanistan's Taliban regime at high speed and at a negligible cost in American lives. Many of those who say now that this fight could have ended no other way talked differently a few months ago. Afghanistan, remember, was the unconquerable natural fortress and the graveyard of the Soviet empire. But if Mr bin Laden hoped to suck America into a long war that would sap its strength while galvanising Muslims to strike against the infidel, he has failed on both counts.

The rout of the Taliban and the installation of a new government under Hamid Karzai made America look powerful, and so gave other would-be sponsors of terrorism a solid reason to change their minds. They also deprived al-Qaeda of its training camps and the sponsorship of a friendly if ramshackle state. These things should make it harder for Mr bin Laden to launch his murderers against the world. This week's battle around Gardez shows that Taliban and al-Qaeda fighters are still at large. But they are ineffectual if they disperse, and at the mercy of American airpower if they congregate. They have become the hunted, not the hunters.

While winning in Afghanistan, America has avoided another trap set by Mr bin Laden. All of this man's *fatwas*, declarations of war and videotaped pronouncements have shown a consistent logic. By waging war on the “Zionist-Crusader alliance”, he hoped to inspire an uprising against all the “puppet” regimes of the Muslim world that are friendly to the West and have failed to interpret Islam to his satisfaction. But in spite of knocking down the twin towers, he has failed to knock down the governments of Pakistan or Saudi Arabia, which were his chief targets. In Pakistan, it is arguable that he achieved the opposite: President Pervez Musharraf's overdue crackdown on the country's wilder Islamists has faced little opposition. The House of Saud has trembled but remained standing. To be sure, Mr bin Laden is admired by many of those Muslims who, for good reasons or for none, resent America. But their resentment has

so far looked containable.

What makes these successes incomplete? In Afghanistan, Mr Karzai's interim government is fragile. If the West now does too little to shore him up—and the Americans show a strange reluctance to fortify their military success with aid and policing—Afghanistan could well relapse into the warlordism that gave an opening to the Taliban in the first place. Moreover, Mr bin Laden himself, whom Mr Bush wanted “dead or alive”, appears to have got away, along with his henchmen.

While its leaders remain at large, it will be hard for intelligence services to gauge how much damage has been inflicted on al-Qaeda's network. Scores of suspected terrorists have been arrested around the world, some through intelligence collected in Afghanistan. But the Afghan training camps spewed out thousands of recruits, of whom many hundreds are thought to be lying low as sleeper cells in scores of countries. It would be premature to take comfort from the absence to date of another devastating terror attack. The “shoe bomber” who tried to blow up an American airliner in December almost succeeded. And September 11th argues against underestimating an organisation that has demonstrated its ability to be patient and methodical as well as utterly ruthless.

Mr Bush warned Americans from the start that the business of tracking down these cells would extend far beyond Afghanistan. The United States has already taken the search to countries as far apart as Yemen and the Philippines. As such actions spread, and especially when they reach places with less co-operative governments, the danger of jeopardising that negative success of Mr Bush's—the avoidance of actions that simply make America more enemies—is liable to grow. Getting this balance right will require fine case-by-case judgments. Being loved is not, after all, the same thing as being safe. But being hated can also become a danger in itself.

Better alone?

One way for America to act against external threats and minimise the danger of being hated for it is to do as much as it can with allies. In Afghanistan, the support of NATO, the Europeans, Russia and many Muslim countries gave America valuable political cover, even if the military contribution of these supporters was small. That was the best of all American worlds: a free hand, plus the sympathy of allies. But support of this sort will be less forthcoming as September 11th recedes and America stretches its definition of the war against terrorism. Mr Bush will often then have to choose between the comfort of alliances and the freedom of independent action.

Iraq presents just such a test. It is an open secret that America has decided to remove Saddam Hussein by force. Almost all of America's Arab allies say that they are against this, and some genuinely may be. So are most Europeans, though not the faithful Tony Blair. The doubters acknowledge that Mr Hussein has broken the terms of the ceasefire he accepted in 1991 and is actively seeking weapons of mass destruction. But Mr Bush's fixation on Iraq puzzles some Europeans. No link has been found between Mr Hussein and September's terror. Is Mr Bush's animus against him therefore a distraction, one that has less to do with the war against terrorism and more with the desire of the younger Bush to finish the job his father failed to finish in 1991?

To see it that way is to misjudge America as well as Mr Bush. For there is a link with the twin towers. As a superpower, America believes that it has both the means—and, since September 11th, the will and the right—to take pre-emptive action against all serious threats to its security. Being only one such threat does not make Mr Hussein less of a danger. The idea that he can be contained by sanctions and deterrence alone is questionable. Over the past decade he has pushed out the inspectors who were tracking down his unconventional weapons and poked gaping holes in the wall of sanctions. In the 1991 Gulf war, he was indeed deterred from using chemical weapons. But it would be foolish to place a lot of faith in the sound judgment of a man who has shot dead his own cabinet ministers, gassed his own citizens, invaded Iran, invaded Kuwait, picked a fight with America and fired missiles at Israel, a country with nuclear weapons of its own.

Mr Bush may feel that ridding Iraq of its dictator is a venture in which freedom of action is worth more than the comfort of alliances. He certainly cannot risk giving timorous Europeans and Arabs any sort of veto. But he must still beware of stoking up resentments that end up making the world more dangerous, not least for America itself—the radicalisation of Mr bin Laden, it is worth remembering, was an unintended consequence of the previous Gulf war. As a rule, that trap will be easier to avoid if America is seen to be acting in a cause that transcends its own narrow interest. And this in turn will be easier if America carries its allies with it as far as possible.

In the Middle East, this suggests two immediate courses of action. The first is to give Mr Hussein a last chance to accept an effective regime of arms inspections—a tougher one, that is, than the one he saw off before. He is unlikely to agree, but his refusal would at least make it easier for Mr Bush's Arab allies to explain the justice of any subsequent American military action to their citizens. For the same reason, at the same time, Mr Bush must send the Arabs stronger proof of his belief in the emergence, quickly, of an independent Palestine.

Linkage, spurious and real

In 1990, when Mr Hussein tried to justify his invasion of Kuwait by demanding Israel's withdrawal from the territory it occupied in 1967, *The Economist* argued against this sort of linkage. Contrary to Arab complaints about “double standards”, the link is still spurious. Mr Hussein launched an unprovoked attack on a neighbour and the UN ordered him to withdraw. In 1967 Israel fought a defensive war, and the UN ordered both it and its neighbours to negotiate a withdrawal. More than 30 years late, and only with American help, Yasser Arafat and Ehud Barak came fingertip-close to doing so at Camp David and Taba. Both sides share a portion of blame for their failure, and for the recent descent into mayhem and bloodshed.

Mr Bush would be as wrong to impose one-sided blame and a one-sided settlement on Israel as on the Palestinians. But he would also be wrong to continue to support Ariel Sharon's attempts to end the *intifada* by force alone, a policy that has most bloodily failed. Whatever the rights and wrongs of Palestine, this is fast becoming the principal regional conflict through which Muslims everywhere define their politics, and by extension their attitude towards America. America has tried to bring peace before, and failed. Now it will simply have to try again. After September 11th, even an America that is tempted to act alone cannot turn its back on the world.

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Zimbabwe

Why it matters

Mar 7th 2002
From The Economist print edition

More is at stake in Zimbabwe this weekend than the future of a once-hopeful country

Reuters

Get article background

IS THE world right to make such a fuss about Zimbabwe's presidential election, which takes place this weekend? Although military rule and dictatorships have largely given way to multi-party elections in Africa, those elections are often imperfect—the polls in Zambia and Madagascar are two recent examples—yet elicit little more than tut-tutting in western capitals. So why get so steamed up about Zimbabwe? Is it just because some white farmers have been thrown off their land?

The land invasions that started in 2000 certainly brought President Robert Mugabe's behaviour to the attention of the popular press in Britain and, to a lesser extent, elsewhere, but the fate of Zimbabwe's white farmers is not the main cause for concern in this election. Rather it is the fate of all Africans, black and white, and not just in Zimbabwe.

Why? First, because Mr Mugabe is trying to establish a new concept of democracy in Africa, a concept so grotesque that it must not be allowed to take root as a standard for other countries. Had he chosen to hang on to power by coup d'état, everyone would have known that Zimbabwe was a dictatorship. But the 78-year-old Mr Mugabe wants both to be a dictator and to be considered legitimately elected. In this quest he has turned black against white. He has harried the press, persecuted the opposition and intimidated the voters. He has packed the courts with yes-men (even getting the Supreme Court to approve his manifestly unlawful land seizures) and driven independent judges from their posts (Ahmed Ebrahim, the sole dissenter in that case, has just announced he will leave the bench in May). He has vetoed some European election monitors, set impossible conditions for others, vetted their supposedly independent Zimbabwean counterparts and delayed their deployment. He has winnowed the voters' roll and turned the administration of the election over to military officers—whose impartiality may be judged by the army chief's hints that he would not let Morgan Tsvangirai, Mr Mugabe's opponent, take office even if he won.

Too bad, you may say, but nothing like as terrible as what has happened in Angola, or Sierra Leone, or Congo. And that is true. But those three countries have been on the ultra-sick list for decades; even before independence, their future looked problematic. Zimbabwe, by contrast, has for 20 of the past 22 years looked rather hopeful. It has the highest literacy rate in Africa (over 80%), an established black middle class, a lively press, vigorous civic organisations and, until recently, an independent judiciary and a relatively sophisticated, well-diversified economy. In little more than two years, though, Mr Mugabe has neutered the judiciary, plundered the treasury and beggared the economy. Even maize meal, the country's staple food, is now in short supply. And all this has been needless: the damage has been inflicted for a single reason only—one old man's desire to hang on to power.

If, by an impossibility, Mr Tsvangirai manages to win, he will face a huge rebuilding job. If he loses, Mr Mugabe, having sown the wind, may find himself unable to reap the whirlwind. Either way, Zimbabweans will suffer. But so too will other Africans. For Mr Mugabe's despoliation of Zimbabwe has taken place with little if any criticism from other African states, who lined up this week at the annual Commonwealth meeting to prevent even denunciation of its perpetrator, allowing only a promise to agree to consider suspending Zimbabwe if the Commonwealth's observers say the poll has been rigged. This comes dangerously close to declaring that African heads of government regard solidarity with doting tyrants more important than sound economic management, free elections and the rule of law—a grim message to be sending in a year when Africa is trying to present itself as newly serious, responsible and deserving

of aid. If Mr Mugabe steals the election and the Commonwealth then refuses to take action, the message will be unambiguous (and the Commonwealth ripe for dissolution). For everyone's sake, except Mr Mugabe's, may Mr Tsvangirai somehow manage to pull it off this weekend.

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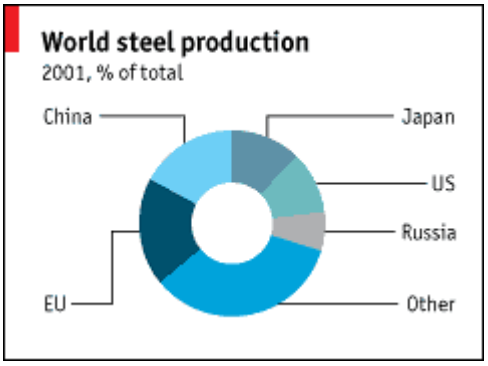
Tariffs on steel

George Bush, protectionist

Mar 7th 2002
From The Economist print edition

The president's decision to place high tariffs on imports of steel is disgraceful

Get article background



NOBODY was surprised, despite affectations of shock in some quarters, when George Bush announced this week his plans to protect the American steel industry. The proposals had been trailed; they were regarded in Washington as politically inescapable. The fact that the president did what everybody expected him to makes this decision no less damaging, and no less stupid.

This steel-tariff plan, it is important to remember, lies well outside the ordinary run of bad economic policy: it is so wrong it makes other kinds of wealth-destroying intervention feel inadequate. And was it really politically inescapable? What a depressingly feeble excuse from a president who has promised, and shown, strong leadership in other respects, and who had claimed, by the way, to be a champion of liberal trade. Mr Bush and his advisers should be ashamed.

More hat, no cattle

The administration has announced a complicated schedule of supposedly temporary high tariffs (ranging up to 30%) on different kinds of steel. Something like $8 billion of imports from Europe, Japan, South Korea and other countries will be affected, about 10% of the world market. It would be bad enough if things stopped there. The policy as it stands will make most Americans worse off, by forcing them to pay more for their steel. Except in the short term it will also do little to help the people it is intended to help—namely, workers in the parts of America's steel industry that cannot compete with foreign suppliers or with America's own more productive mini-mills.

The day after the tariffs were announced, National Steel joined the many other American steel makers already in bankruptcy (see article). Tariffs fail to address the real problem—high costs, including “legacy liabilities” in health-care and pension benefits. Many companies will fold anyway. When they do, putting workers out of a job and rendering those promised benefits null, the tariffs will only make the victims, as consumers, even worse off than they would have been.

But the rot does not stop there. Europe now expects to face a surge in steel imports, and may well adopt the same self-destructive remedy. The damage will scale up globally, possibly spreading to other kinds of trade, and a good part of the cost will end up with developing-country producers. The leaders of Europe and the United States love to preach liberal trade to the benighted rulers of the developing world, and never tire of promising better access to their own markets. Fine words.

The outrage in Europe's governments over the tariffs, like the shock at the news, is synthetic. Europe has forgotten more than America will ever know about trade protection (common agricultural policy, *passim*). The linkage now being advanced in Europe between, on one side, America's need for allies and, on the other, its protectionist affront to those friends, is also largely bogus. There is a long tradition in transatlantic relations of allowing mutually burdensome trade illiteracy to flourish in its own separate domain. But there is no need for additional unpersuasive criticisms of American policy. The straightforward case against what the administration has done is shaming enough on its own.

What then should Mr Bush have done? As we argued last week, the principle should be “protect the

worker, not the industry". The government should improve its assistance programmes for workers who lose their health-care benefits and pensions when firms fail, and it should look at new and more generous ways of helping workers find new jobs. These policies cost money, of course—but so does shutting out imports, and far more so, the only other difference being that the effect is disguised. It requires political spine, sometimes, to do the right thing. Mr Bush was supposed to have one.

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Thailand

A step backwards

Mar 7th 2002
From The Economist print edition

By cracking down on the press, Thailand is moving in the wrong direction

Get article background

EPA

LAST week, we published a generally upbeat survey of Thailand. For our pains, the government blocked the distribution of the edition. A week or so earlier, it had told two journalists from the *Far Eastern Economic Review* that their visas were to be revoked (a sanction subsequently withdrawn after the magazine apologised). Both *The Economist* and the *Review* had published articles that, apparently, threatened the stability of the country by daring to discuss its monarchy—though *The Economist*, at least, was never formally informed of its sin.

It is true that most Thais revere their monarchy, but the survey contained only five paragraphs on the subject. It did, however, say much more about the many conflicts of interest surrounding Thaksin Shinawatra, who is at once prime minister and Thailand's biggest businessman. Similarly, the offending article in the *Review* was less about the monarchy than about the king's alleged unhappiness with Mr Thaksin.

If the foreign press is having a tough time just now, it is as nothing compared with what the domestic media have to suffer. Already, independence has disappeared from television: Mr Thaksin acquired the only non-state-owned broadcaster, iTV, before last year's election, and many of its journalists were subsequently fired. Those who remain complain of pressure to report the news in a pro-government way. Radio journalists fare much the same: after the broadcast of an interview that was critical of Mr Thaksin, the government this week ordered a radio station to stop taking news reports from one of the country's few independent sources, the Nation Multimedia group. Though the press fares better, editors say Mr Thaksin's family businesses use their financial muscle to discourage criticism of the prime minister by withholding advertising from papers that voice it. A leading Thai polling organisation complains of intimidation, saying police raided its offices after one of its surveys showed a fall in Mr Thaksin's popularity.

Until recently, the press has been delightfully free in Thailand. Now the trend is towards the authoritarianism of Malaysia. There, Mahathir Mohamad allows almost no freedom, either for the international press—one recent week saw *The Economist*, the *Review*, *Time* and *Newsweek* all blocked—or for the local media, which are almost completely muzzled. It would be sad if Thailand went down that path. Fortunately, as many Thais have discovered, our survey is available free on our website, at www.economist.com/surveys.

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Managing in hard times

Revival of the fittest

Mar 7th 2002
From The Economist print edition

The recession is teaching new managers old tricks

THESE are miserable times for managers. Everything is being cut—jobs, budgets, investment plans, bonuses and perks. The fun is being squeezed out of work in an effort to make profits respectable again. Top of the league last season, managers now feel as if they are half way through a new season and have yet to win a match. It is dispiriting enough to make them wish for a transfer. If only there were somewhere else to go.

It need not have been so bad. For it is clear now that in the euphoria of last season's victories, managers lost sight of some of the fundamental principles of their game. First, and most dangerously, they began to believe in their own invincibility. Egged on by analysts, investment bankers and consultants, they thought that nothing was beyond them. They had no fear of failure: fear would have meant they were being insufficiently “visionary” or “revolutionary” in their thinking about the opportunities presented by the Internet.

Then they began to party a little too often. The executive jets, the teams of “advisers”, and the brand puffed up to match the ego. Why, for heaven's sake, drink blush zinfandel when you can afford Château Pétrus? After a while, inevitably, the parties began to eat into other activities. Managers cut back on planning. The future would take care of itself. All it needed was a succession of mergers and acquisitions to enable them to extend their unquestioned brilliance into new fields.

Now the party is well and truly over and it is time for some regrets. The economic slowdown is bringing home the value of timeless old-fashioned virtues. Managers are learning anew that to succeed in good times and in bad they need, above all, to be consistently honest, frugal and prepared (see article). Honest with themselves and with their audience about their true capability; frugal in their use of what is usually other people's money; and prepared for almost any eventuality. The go-go years at the turn of the century made it seem as though things would never be the same again. But that was an illusion. For here we are, back in the doldrums. Good business is hard to come by, and fortune favours the prepared mind.

One consultant says managers are finding the situation as difficult to cope with “as their first hangover in college”. Few of them have been here before. The last comparable recession in America and Europe was a decade ago. Many managers are learning the value of these old-fashioned virtues for the first time. They will serve them well. At least until the first distracting victories of next season.

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Letters

Mar 7th 2002
From The Economist print edition

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Vouching against

SIR – Your support for school vouchers ("Hands up for vouchers", February 23rd) reads like a thinly veiled argument in favour of public subsidies to private business. In Australia, private schools have received direct government payments for over 25 years. Despite this, tuition fees have risen to record levels. More recently private health-insurance providers have reacted to government subsidies in exactly the same manner.

In return for this massive investment, governments have seen private schools lift their proportion of enrolments from an early 1970s "crisis" of a 22% share to 30% now. The composition has remained stubbornly skewed towards the wealthy. However, the enduring bias of class and wealth in private schools only partly explains the failure of public subsidies. The end-of-school performance scores of students from even elite private schools are all but indistinguishable from those of students in the government systems.

Jim Wellsmore
Marsfield, Australia

SIR – You say that voucher programmes are too small and short-lived to provide empirical evidence of their efficacy. In fact, Chile implemented a national voucher system in 1980, with the state paying a fixed amount of money to the schools (indirect vouchers) on the basis of enrolment. The market reaction was fast: the number of private schools operating in the country jumped in the following decade and the proportion of students attending the private system increased from around 12% to 40%. Even though Chile is vastly Catholic, the new schools entering the system were mainly non-religious and for profit.

However, academic results did not improve; with the same amount of money, but less bureaucratic controls and more incentives, private-voucher schools now perform as poorly as publicly run schools after controlling for the variables associated with family background.

Maria Jose Ramirez
Boston

SIR – The most insidious aspect of America's poor inner-city public schools is the effect on the demographics of cities. You must either be very rich or very poor to raise a family in most large American cities. Middle-class parents, such as my wife and I, can send our children to a decent public school only by moving to a larger house in the distant suburbs (with the interest on the house payment being tax deductible).

Alternatively, we can keep our smaller house in the city and pay for (non-tax deductible) private schooling. If school vouchers allow middle-class parents a meaningful choice in education, it will help slow or reverse the resource-sapping flight to the suburbs.

Mark Agee
Dallas

Regulation answer

SIR – In your leader on energy you say that deregulation “should not be equated with no regulation” (“It's good for you”, February 16th). This is a true and widely misunderstood point. One reason that it is misunderstood is that the wrong term is used. Should we not use a more honest term, “regulatory reform”, in place of “deregulation”? And, in all the discussion of California's flawed deregulation plan, am I the only one who finds deregulation plan a contradiction in terms?

However, when we recognise that deregulation does not really mean getting rid of all regulations, we also give up the most important argument for deregulation. The argument is that a regulatory scheme can be captured by the monopolists it is supposed to control, and transformed into “a conspiracy against the public, [a] contrivance to raise prices,” to borrow Adam Smith's words. But regulatory reform, too, can be captured. Is that not exactly what happened with California's power market? And the relative vagueness and opacity of the regulations under regulatory reform seem to lend themselves to capture. We are not far from the time when a serious historical judgment can be made of the relative merits of traditional regulation and those of regulatory reform, and it is not clear that the finding can be for reform.

Roger McCain
Drexel University
Philadelphia

Mbeki and AIDS

SIR – Central to Thabo Mbeki's stance on HIV and AIDS is his ideological reluctance to recognise personal responsibility as a reason for the spread of the infection (“Stop denying the killer bug”, February 23rd). As a consequence, young blacks see no reason to take precautions against infection. If South Africa's government were white and followed the present course, there would be justifiable howls of “racist genocide” from all quarters. The inaction of the present government of South Africa constitutes as much a crime against humanity as was apartheid, and history will be harsh in its judgment.

R.H. Blake
Johannesburg

SIR – Leave Mr Mbeki alone to ponder his dilemma, caught as he is between whatever AIDS is in his unfortunate country and pressure from the AIDS establishment, which has spent $93 billion to so little effect. No new drug, no vaccine, nothing but propaganda.

P.M.K. Hyde
London

Second-hand account

SIR – You article on car plants (“Incredible shrinking plants”, February 23rd) is too influenced by America's car industry and its problems. Many of the methods highlighted have long been operational in Europe and elsewhere, and it is by no means certain that the large plant is in trouble.

The car industry is conservative with good reason. The existence of the used-car market makes car buyers reluctant to purchase “revolutionary” products which may be hard to resell. Even so, electronics will continue their long-established advance, but to say that fuel cells are close to cost-competitive mass-production is brave and hopelessly optimistic. In any event, the spread of the hydrogen society to the car sector could also happen through the hydrogen-powered internal-combustion engine—but not for decades.

The bottom line is that plants making powertrains and suspension also have decades of life ahead of them. So shrinking car plants? Not unless you are willing to pay more for your car as economies of scale are perversely destroyed.

Garel Rhys
Cardiff University Business School
Cardiff

SIR – Your report on the car industry includes a provocative chart whose relevance extends well beyond any single industry. It shows regulation as the cause of over $2,000 in additional costs per car during the

past decade. This is broadly consistent with economy-wide estimates of regulatory costs that I completed recently with Mark Crain of George Mason University ("The Impact of Regulatory Costs on Small Firms"). We show that American firms spend nearly $5,000 per employee annually to comply with federal regulation. The sheer size of this burden invites closer scrutiny.

Thomas Hopkins
Rochester Institute of Technology
Rochester, New York

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About sponsorship

The war in Afghanistan

Satellites and horsemen

Mar 7th 2002
From The Economist print edition

Getty

Fighting has flared up again in Afghanistan. Does this mean that the nature of this war, and the military lessons to be drawn from it, have changed?

Get article background

SOME of the heaviest fighting of the war is now raging in eastern Afghanistan. American ground troops, supplemented by detachments from Australia, Denmark, France, Germany and Norway, are trying to destroy the remnants of al-Qaeda that are still holding out in Paktia province. South of Gardez, they have met sustained and determined resistance. Since the attack began, on March 3rd, nine Americans have died, seven of them from rifle fire as helicopters tried to supply the men on the ground.

The travails of Operation Anaconda, as this assault is known, raise obvious doubts about America's much-vaunted success in this war. Although the campaign from the air removed the Taliban from Kabul in a mere two months, America now seems engaged in an older and much more risky kind of war, involving the ground troops and body bags that it has always sought to avoid. Nor is the job finished. The al-Qaeda network is still in existence, though severely mauled; the fate of most of its leaders, including Osama bin Laden, is unknown. In the end, there may be no technology that will completely neutralise people as desperate and determined as the hijackers who struck on September 11th.

Yet in the rooms where war planning is done, the setback at Gardez is seen as just that: a temporary reverse that does not negate the lessons which have already been drawn from Afghanistan. America's war there has brought new refinements, undreamed of even a year ago, in the art of delivering deadly firepower at long range with devastating accuracy. It has also demonstrated that nothing is too old, or too new, to be used on a battlefield where several eras of human history seem to coexist.

The evolution of smartness

Afghanistan presented unusual challenges, from the height of its mountains and the depth of its caves to its position far inland, beyond the normal reach of sea power. Yet each of America's recent military adversaries has presented difficulties of its own. As these have been met, so a new style of warfare has steadily evolved.

The American-led air war of 1991 that drove Saddam Hussein's troops out of Kuwait broke new ground by introducing the world to the concept of precision-guided or “smart” munitions. Pundits concluded that the division of labour between air and land warfare had changed in favour of the air; in future campaigns, land forces would be introduced at a relatively late stage, after the enemy's forces had been devastated from above.

The NATO bombing campaign against Serbia in 1999 used a much bigger proportion of smart bombs. That campaign appeared to prove that it was possible to “win a war” by air power alone—if by winning one means inflicting well-calibrated doses of pain until the opposing side has no choice but to sue for peace. But there was relatively little real co-ordination between events on the ground and NATO's bombing. Serbia's forces were not chased out of Kosovo; Slobodan Milosevic was obliged to withdraw his (relatively intact) forces because his security establishment, economy and society were suffering so much pain on other fronts.

The extraordinary innovation in Afghanistan has been the close synchronisation of land and air power. American and British special forces and their local allies have been able to use their vantage points near the heat of the battle to “call in” American bombers to drop their deadly loads where they are most effective.

Donald Rumsfeld, America's defence secretary, has often recounted with relish the story of how American special forces helped to orchestrate the fall of Mazar-i-Sharif. Soon after landing in Afghanistan, these top-notch troops requested, and received, air drops of boots, ammunition—and oats. Blending into the Afghan scene with their beards and scarves, the Americans mastered the art of horsemanship on wooden saddles and made spine-tingling night-time treks along mountain trails with minefields nearby. Once they had established working relations with their Afghan allies, the special forces used hand-held computers to communicate with their airborne comrades and bring the bombs raining down on the enemy. This in turn prepared the way for what Mr Rumsfeld has called the “first cavalry charge of the 21st century”.

The battle for Mazar had its tragic side, too, even from a purely American viewpoint; in at least one case precision-guided munitions came down in the wrong place, landing on American and allied soldiers, either because the wrong codes had been tapped in, or because the guidance system did not work. But for advocates of high-tech air power the campaign against the Taliban was proof that the Pentagon can improvise, mix and match as circumstances require, drawing on relatively cheap equipment as well as very expensive bombers.

Low-cost winners

In technological terms, the war has brought new triumphs for the Joint Direct Attack Munition (JDAM). This device, costing $21,000, can be attached to a simple gravity bomb to make it into a satellite-guided weapon capable of falling within ten metres (30 feet) of the target. During the Kosovo war of 1999, the only aircraft that could drop JDAMs effectively was the B-2, the giant, bat-winged bomber which has to fly out from Missouri. B-2s cost $1.2 billion each.

Over Afghanistan, JDAMs have been used by a wider range of aircraft. One of the biggest factors influencing a possible war with Iraq is the availability of these strap-on devices. Boeing is labouring to increase the production rate at its Missouri factory from the current level of 1,500 a month. But the Pentagon acknowledges that stocks have been badly depleted by the Afghan engagement, which at one point required more than 80 JDAMS a day.

The other low-cost winner in Afghanistan has been the Predator, an unmanned aerial vehicle (UAV) which was developed less than a decade ago by an obscure company in San Diego. Having already proved itself in Kosovo as a cheap, dispensable eye-in-the-sky, the Predator came into its own in Afghanistan by watching elusive or “fleeting” targets and showing that it could be used as a strike weapon, delivering Hellfire missiles. These artful little machines have also proved their worth as part of a complex communication system including far more expensive pieces of kit, such as the Global Hawk, an unmanned reconnaissance aircraft which flies at 65,000 feet and had its combat debut in Afghanistan. Images gathered by the Predator are fed into the weapons-control cabin of AC-130U gunships and passed straight to the White House, where President George Bush has been able to observe the battlefield almost in real time.

Images gathered by the Predator have enabled President George Bush to observe the battlefield almost in real time

“These days, being against unmanned airborne vehicles like the Predator is like being against apple pie,” says Loren Thomson, a military analyst with the Lexington Institute, a think-tank. He predicts, though, that some of the more exaggerated claims made on behalf of UAVs may in time be modified. When faced with sophisticated air defences that could shoot large numbers of Predators down, the relative cost of maintaining a UAV fleet would rise.

In practice, however, the future of warfare may lie with ever more ingenious combinations of old and new, costly and cheap. Until recently, conventional military thinking imagined a war-fighting network in which different “platforms” (a generic term for aircraft, ships, tanks or any large piece of military equipment) would be used to unleash weapons, gather data and, in fact, command the whole operation. Now, to an increasing extent, all these functions can be combined on a single platform, sometimes in innovative ways.

Inevitably, almost every interest-group in America's interminable defence debate claims some vindication from the Afghan conflict. Supporters of land-based, long-range heavy bombers, such as the B1 and the B52, point out that about two-thirds of the ordnance so far dropped on Afghanistan has come from aircraft of this type. But navy buffs have pointed out that, of the smart weapons dropped, a slightly higher proportion (47%) have been unleashed by carrier-based aircraft than by heavy bombers, which accounted for 43%. More than ever before, fighter aircraft left their carriers without knowing what they would end up striking. Only in flight, as ever more precise information was gathered from the battlefield, would the pilots be told where to go.

Even the Pentagon's biggest bombs have been used in unexpected ways. The 15,000-lb “daisy cutter”, which is supposed to spread devastation over a broad area, was not previously seen as a weapon to be used against what the Pentagon calls “hard and deeply buried targets”. But in Afghanistan the giant bomb has been used with the intention of “turning caves into tombs” by wrecking the vast caverns where al-Qaeda fighters were thought to be lurking, and trapping or asphyxiating those inside.

Self-imposed restraint

The Taliban's defeat has demonstrated a synergy between new, expensive gadgetry and cheap kit, and between computer boffins and tribesmen on horses. But could the same result have been achieved with high-tech and massive firepower alone? Was the inclusion of horse-borne Afghans and saddle-sore Americans simply a piece of theatre, designed to capture the imagination of American voters?

Technically speaking, air power alone might certainly have been able to do the job; American bombers could have brought the Taliban regime to an even swifter end by attacking Kabul and the other main cities of Afghanistan with indiscriminate force. But such a tactic would also have wrecked all claims to “legitimacy” in the eyes of the people of Afghanistan and the rest of the Muslim world. The spectacular synergy between local fighters and special forces on the ground, combined with long-range air power, helped to ensure that America's massive bombs were delivered in a relatively accurate way. Otherwise, the world's abiding impression of the war would have been of one of the richest countries pulverising one of the poorest.

But for America's accuracy, the world's impression of the war would have been of one of the richest countries pulverising one of the poorest

One of the features of modern warfare is that—partly because of television's ability to disseminate images round the world—all parties feel constrained in their use of firepower. During the Balkan wars of the early 1990s, for example, both the local parties and the West were playing a careful, calculating game of “How far can you go?” The Serb forces besieging Sarajevo had enough armour to overrun the city, wreaking even more human misery; but to have done so would have triggered instant western intervention. On the other side, the Serbs' outgunned adversaries—whether Bosnian, Croat or ethnic-Albanian—hoped to goad their foes into crossing the line where such intervention became inevitable, a hope that was eventually realised.

AP

Supremacy in the air, still a hard slog on the ground

America, arguably, should have less need to play such games. It is powerful enough not only to prevail in

any conflict, but also to set the rules. Yet as diplomats from the State Department keep reminding their opposite numbers in the Pentagon and the White House, the application of firepower—be it ever so smart—can often have unintended effects that go far beyond the immediate targets. For example, had America dislodged the Taliban in a devastatingly cruel way, the government in neighbouring Pakistan might have fallen. If war is declared on Iraq, the Bush administration will have to make fresh calculations between legitimacy and firepower and, as Michael O'Hanlon of the Brookings Institution says, between the safety of America's pilots and the moral imperative to be as accurate as possible.

The drag of friends

Another source of “legitimacy” for American military campaigns is the ability to assemble a broad coalition of allies. Neither in the Gulf war in 1991 nor in the air war against Serbia did America's armed forces need any help, except at the margins, from other countries. But the involvement of many different countries helped to blunt the perception of a giant nation bullying a small one. Even in 1983, when American forces invaded the island of Grenada, the involvement of a coalition of tiny Caribbean countries was an important source of legitimacy.

The air war against Afghanistan, while relying on basing rights and overflight facilities from other countries—some of them, formally speaking, allies, others far from it—may be remembered as the moment when the Pentagon successfully insisted on fighting alone, or virtually alone, when the battle was at its toughest. Only when conditions eased could American forces allow themselves the luxury of incorporating other countries into their war plan. Operation Anaconda has proved an exception to this rule.

The bombing campaign against Serbia is still recalled with a shudder by American air-force commanders. They remember that they were given a task to accomplish—bending the will of Mr Milosevic—but were denied the freedom of action to inflict as much pain on Serbia as they deemed necessary, because some NATO allies were squeamish. Technological developments—and in particular the sharply reduced time lag between “sensor and shooter”—have strengthened the Pentagon's preference for fighting alone. When it is technically possible for a target identified by a drone or satellite to be struck ten minutes later, the idea of having to spend several days winning approval from the leaders of 19 countries (as during the Kosovo war) is even more unattractive to military commanders.

The idea of spending several days winning approval from leaders of 19 countries (as during the Kosovo war) is ever more unattractive to military commanders

It was an open secret, after the Kosovo war, that American commanders were disappointed by their allies' lack of precision-guided weapons, electronic-warfare equipment and secure communications. The alliance as a whole agreed on the desirability of closing the gap, and some countries, especially Britain, set out to smarten up their air power. But during the Afghan war there has been a new toughness in the Pentagon's message to countries that long for the prestige and influence that may come from fighting alongside America in high-tech, high-intensity warfare. “They have simply decided that we are not worth the trouble,” says Andrew Brookes, an air-power analyst at the International Institute for Strategic Studies in London.

With every advance in American technology, the cost of stooping low enough to bring allies into the battlefield grows higher. “Imagine if an allied pilot was shot down because of poor equipment,” says Mr Brookes. “The Pentagon would have to divert a huge amount of resources to a search-and-rescue operation, and they would be furious about that.” This disparity may widen if, as seems likely, America's next adversary has more sophisticated air defences than the Taliban had.

Britain has contributed to the air campaign over Afghanistan in some specific ways. The most important was to provide special forces, whose excellence is widely acknowledged. Britain has also helped with air-to-air refuelling, thus extending the effective range of America's carrier-based bombers, and agreed to the use of Diego Garcia, a British island in the Indian Ocean, as a base for heavy bombers. By firing some of its tiny (by American standards) stock of sea-based cruise missiles, Britain could also claim to be taking part in the “sharp end” of America's military effort. Much later, after the Taliban had fallen, Britain regained centre-stage as the lead-nation in a small peacekeeping force.

But does this mean that America's next air war will be constrained by British political influence, as the war against Serbia was restrained by France? It seems far more likely that the Pentagon will keep its own counsel, mixing and matching from the vast variety of forces at its own disposal, and taking assistance

from allies, ranging from Afghan tribesmen to former Soviet satellites, as and when required. The chief lesson of Afghanistan, for America, is that it can fight its wars by itself.

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America and Europe

Who needs whom?

Mar 7th 2002 | WASHINGTON, DC
From The Economist print edition

America must soon decide whether to deal with terrorists and weapons of mass destruction in partnership with Europe, or alone

IN THE coming months, America and Europe will confront an issue that will define their relations for decades. It has comparatively little to do with the megaphone diplomacy that has blared out a crisis in the alliance over the past few weeks. The issue is Iraq.

Late last winter, as George Bush resolved that dealing with the new threat to America meant curbing weapons of mass destruction as well as fighting terror, his administration at last determined to overthrow the regime in Baghdad. The issue is no longer whether to seek a change of regime, but how and when. That decision sets the scene for bigger questions about the future of the transatlantic alliance.

Should the Bush administration accept European help against Iraq even if it is offered?

The immediate issue confronting Europe is whether to join America's attempt to overthrow Saddam. The Europeans do not want a change of regime for its own sake, but may decide it is the only way to prevent Iraq using the chemical, biological and possibly nuclear weapons it has or is still seeking. The question for the Bush administration is whether to accept European help even if it is offered.

If it does so, the transatlantic alliance will become the main western combatant in the great struggle of the early 21st century, as it was in the great struggle of the second half of the 20th century, against communism. That should reinforce the relationship, even if Iraq became controversial in European public opinion, as it surely would. If the Europeans choose not to join, or if they ask but Mr Bush rebuffs them, then the battle will still go on, but as an American operation.

Europeans would not be irrelevant. They would continue to play important roles in the war against terror (policing, financial operations and intelligence-sharing). Nor would the transatlantic alliance be finished. The expansion of the North Atlantic Treaty Organisation, its main institutional expression, would continue, and so would the great attempt to bring Russia into a pan-European security framework.

But these are the unfinished parts of the “old agenda” of the cold war. Europeans were integral to that because Europe was the place where a third world war was most likely to start. That is not true of the struggle against terrorism. If Europeans were sidelined, then the new agenda would be led and defined by America, and Europe would have little say in how future threats would be faced.

Neither side has yet decided what to do. But decisions cannot be long in coming. If the campaign to oust Saddam means invading Iraq (and it is not yet certain that it does), months will be needed to prepare, and longer if reintroducing United Nations weapons inspectors is the first part of the operation. And, as Mr Bush said in his state-of-the-union speech in January, time is not on his side. Britain's Tony Blair will visit Washington soon, and the strategic decisions may well be taken then. They will determine not only the future of Iraq, but of Europe and America.

Warriors and EU-nuchs

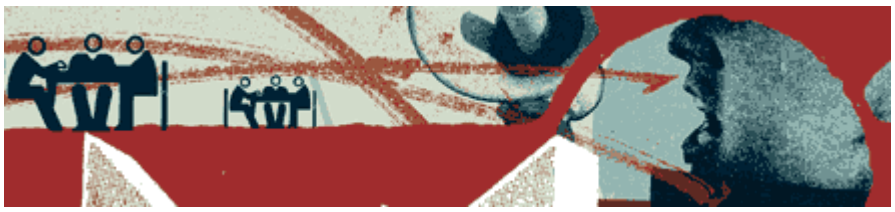
On the face of it, the portents are grim. Mr Bush's “axis of evil” speech, in which he singled out North

Korea, Iran and Iraq as proliferators and therefore threats to peace, produced wailing and gnashing of teeth. “Simplistic”, said France's foreign minister, Hubert Védrine. “We won't be treated as satellites,” cried his German opposite number. Chris Patten, the EU's foreign-affairs commissioner, added that America was going into “unilateralist overdrive”.

The nub of this wailing is summed up in Mr Védrine's word. Europeans feel that America, wounded and fired up for action, is ignoring the root causes of terror and, above all, the Middle East. In the autumn, when Mr Bush was rallying the alliance against al-Qaeda, a Palestinian state was mentioned. Some think this was merely a ploy to get Arabs and Europeans on-side, with America giving a green light ever since to the thuggish policies of Ariel Sharon, Israel's prime minister. Many Europeans also fear that overthrowing Saddam would destabilise the region, and they regard America's willingness to take this risk as part of a wider disdain for the feelings of the Arab street.

Europeans feel that America is ignoring the root causes of terror and, above all, the Middle East

America's gnashing of teeth has been less well reported, but ought to be just as shocking to Europeans as the European reaction was to Americans. True, Colin Powell, the secretary of state, has been soothing, saying he “would have a word” with friends who are worried about America's behaviour. But others in the administration say privately what columnists commit to print. As Charles Krauthammer put it in the *Washington Post*, “We are in a war of self-defence. It is also a war for western civilisation. If the Europeans refuse to see themselves as part of this struggle, fine. If they wish to abdicate, fine. We will let them hold our coats.”



Away from the megaphones, however, matters are more complicated than they seem. In Europe, there are two main opinions about dealing with weapons of mass terror. One is the “axis of subtlety”. This implies that Europe ought to have its own policies towards Iran, Iraq and North Korea, and should not necessarily join in any American attempt to overthrow Saddam. They feel, in any case, that the connection between war on terror and war on Iraq has not yet properly been made. The other view is Mr Blair's, reiterated in the *Daily Express* on March 6th, that “the international community...must prevent” Mr Hussein developing and using his weapons. This keeps open the possibility of British involvement in Iraq, though, as Mr Blair has said elsewhere, “what action we take in respect of that is an open matter.”

In America there are three different views of European involvement, were it to be offered. These views are rooted in different views of the transatlantic relationship in general, and NATO in particular. The first two would probably reject European involvement, albeit for different reasons.

The first school of thought considers that the transatlantic relationship has gone about as far as it can. It is sceptical of a proposed large expansion of NATO at a summit in Prague later this year (something Mr Bush is on record as supporting). It is still more dubious about proposals for closer co-operation between NATO and Russia. As to Iraq, while it might be willing to tolerate some NATO help, it wants that help to come from individual countries and to be no different in kind from the assistance of, say, Australia or Kuwait. This, after all, was how the Gulf war was fought.

According to this school of thought—which might be called the Perle school, after Richard Perle, the chairman of the Pentagon's defence policy board—America has a brief window of opportunity before Mr Hussein acquires even more dreadful weapons. If the Europeans were brought in, they would slow everything down and the opportunity would pass before the alliance could do anything useful.

The second school is also reluctant to involve Europeans, but for almost exactly the opposite reason. It thinks NATO is doing a splendid job and should keep on doing it—in Europe. This school is more concerned than anyone else about the unfinished agenda of the cold war. It wants the biggest, fastest expansion of NATO possible in order to bring all of Central and Eastern Europe into the alliance. It then wants to integrate Russia and Ukraine into a wider European security system through a NATO-Russia council. It would accept a division of labour in which America fought the big wars and Europe confined itself to peacekeeping, especially in its own Balkan backyard.

But this school sees a trade-off between the old agenda and the new. Adventures in Iraq, its adherents fear, would distract NATO, so they also want the Europeans to concentrate on a secure Europe, leaving America to deal with the rest of the world. This is the view of several members of the National Security Council under Condoleezza Rice.

Only the third school wants Europeans to involve themselves beyond their shores. It takes a somewhat more sanguine view of the old agenda, arguing that the transatlantic partners have now done enough and can turn their attention to other matters. It views NATO as the natural defence arm not only of Europe but of everything affecting the West, and therefore wants it to be the main instrument for dealing with terrorism and weapons of mass destruction. This view is loudly promoted by internationalist Republicans, more quietly backed by “NATO-niks” at the State Department, and has been slowly gaining ground in Washington of late.

The real debate that underlies all this is whether to fight terror co-operatively or separately. The key decision-makers—Mr Bush, Mr Blair, Gerhard Schröder, Vladimir Putin—have yet to show their hands. From America's point of view, the three questions are: Can we trust the Europeans? What practical use would they be anyway? And since they would be forced by their own self-interest to follow whatever we do in any case, do we have to listen to them?

Trying to adjust

The recent criticisms from France and Germany are feeding American fears that Europeans are too lily-livered to be trusted in the struggle against terror. Europeans respond that it is not a question of timorousness, merely of a different point of view. Many are both unhappy with what they see as America's unilateral approach, and angry at their own inability to do much about it. Others, recognising their powerlessness, do not want to break ranks with the United States. The prime ministers of both Italy and Spain welcomed the “axis of evil” speech, with Jose Maria Aznar comparing it to Harry's Truman's rallying of the West against Soviet communism. Britain, at least from Mr Blair's mouth, continues to say the right things. As long as these countries stay behind America, this alone would negate the notion that Europeans collectively are appeasers.

Of course that would still leave Germany and France (whose permanent seat on the UN Security Council gives it an importance beyond its role in the EU). But their opposition to overthrowing Saddam may not be quite what it seems either. Both France and Germany hold elections this year, and some politicians may have an interest in using anti-American language to rally their electoral base—especially Joschka Fischer, whose Green party faces obliteration in Germany's poll.

In short, this may be one more episode in the long history of European struggles to adjust themselves to an American strategic initiative. The same thing happened after Ronald Reagan's “evil empire” speech. Then, initial dismay was followed by the installation of medium-range missiles in Europe and the eventual collapse of the Soviet Union. Perhaps a similar adjustment may happen on Iraq.

All right, say America-firsters, but even supposing Europeans were willing to give political support to a campaign against Saddam, what practical use would they be? Their defence spending is pitiful. Their military technology is a generation behind ours. And we didn't need them in Afghanistan anyway. Yes, it's true that NATO invoked its Article 5 on September 12th, holding that an attack on one member was an attack on all. But in practice, America has used little alliance help.

This line of criticism will be harder to rebut, because at least some of it is right. Europeans and Americans who think the alliance has a role fighting global terror could argue that the campaign in Afghanistan, far from being the archetypal conflict in the new kind of war, is actually an exception. There was little time for preparation. America was striking back after September 11th and could not afford to wait. That would not be true in the case of Iraq.

Even so, this optimistic view does not take account of Europe's falling military capability. On one measure, America spends a staggering 40% of all the money the world spends on defence. The Pentagon's budget is now over ten times that of the next biggest military spender in NATO (Britain). This gap in resources translates into a technology gap, as Europeans would have found in Afghanistan. No wonder Lord Robertson, NATO's secretary-general, worries aloud about European “pygmies”. This difference in military might, which will be exacerbated by the proposed leap in America's defence spending this year,

The Pentagon's budget is now over ten times that of the next biggest military spender in NATO

explains much of the alarm in Europe about the Bush administration. America is waking up to the huge preponderance of its military power. Europe, realising this, is worried both about the wise applicaton of that power, and its own relative weakness.

(Britain). This worries Europeans

The difference between the two is the product of many years of neglect by Europeans, who have preferred to spend public money on social services. That cannot be changed quickly, and many in Europe and America do not want to change it anyway. They like things the way they are. Europeans do not want to give up their butter for more guns, not least because they feel there is no threat at present that would justify attempting to close such a yawning gap in capability. Americans have not been unduly worried about Europe's failure to compete, since it increases their own freedom of action. Indeed, they might be far more alarmed if the Europeans were really to make their promised EU defence force credible, and demand a greater say in decision-making as a result. Hence neither side has a strong interest in rebalancing the relationship.

That said, even at current spending levels, Europe's contribution would not be zero. As Mr Bush has repeated *ad nauseam*, this is a new kind of war in which policing, intelligence-sharing and financial sanctions will be as important as military might. Europe's usefulness in all these areas would not be limited by its feeble defence budgets. And since no one has yet decided what sort of military action might be taken against Iraq, it is also premature to decide that European forces will be incapable of contributing to it. Just as important, it is wrong to write off European defences as essentially useless, especially now that some missile-guidance and surveillance technologies can be bought relatively cheaply off the shelf.

So, for all their doubts and difficulties, Europeans might be willing to take part in a campaign against Mr Hussein, and could turn out to be useful. That means that the crux of the matter must be in the third question: if Europe is bound to follow America anyway, does Mr Bush have to care about what Europeans think?

The need to listen

There are several reasons why he should, and they boil down to the argument that the events of September 11th brought America and Europe closer together. Europe is the other western target of al-Qaeda's hatred, and has an overwhelming community of interest with America. Since many of al-Qaeda's sleeper cells are in Europe, the continent's police, spies and financial-fraud busters will do what they can to neutralise terrorist cells. If the next terrorist strike were in, say, Paris or London, America would not be going it alone.

But reasons why the two sides should co-operate may not matter now in Washington. This is an administration animated by realpolitik and a keen sense of its own power. For many, the best definition of what should be done is what America wants to do. If it overthrows Mr Hussein without European help, and installs a more democratic government in Baghdad, will Europeans complain? No. If America ignores Europe over Iraq, would Europeans become hostile to the expansions of NATO or the EU? Of course not.

Hence, for those in the administration who do not seek European help in the war on terror, the question is not, “Do we have a community of interest?” (to which the answer is obviously Yes), but “What would Europeans do differently if we ignored them?” And their answer seems to be: not very much. Europeans will deploy their police forces and spies out of their own self-interest. They may back an anti-Saddam alliance for the same reason. Many in the administration think these are reasons for ignoring, not for co-operating with, Europe.

What would Europeans do differently if America ignored them? One answer is: not very much

From this point of view, justification for co-operation may have to be sought in those things that European countries may not do out of self-interest, but America wants to see happen. The administration, for example, is assuming others will step in to do the government-building and post-conquest reconstruction that America thinks beneath it. Others are already offering the lion's share of reconstruction aid in Afghanistan. But what if they balk? Already Britain, the leader of the Afghan peacekeeping force, is hesitating about extending its operations outside Kabul and beyond its six-month mandate.

The administration also wants to avoid a bust-up with Russia over Iraq. Perhaps the best way to do that would be to step up co-operation between Russia and NATO, which requires European backing. And then there are the countries, plenty of them, where Europeans have as much (or more) intelligence and

diplomatic leverage as America. If America ignores Europeans in Iraq, Europe may ignore America in other vital corners of the world.

These are cold, even mean-minded, calculations of opportunity-cost. The big question matters far more: which is more important to the administration in the war against weapons of mass terror, America's unfettered freedom of action or the Atlantic alliance?

This is a question only Mr Bush can answer. But the stakes are as high as they can be. Either the president gives the transatlantic alliance a new reason for existing in the 21st century; or one more victim will be added to the toll of September 11th, the future of the alliance itself.

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The California primary

Nothing but gravel in their pan

Mar 7th 2002 | SAN FRANCISCO
From The Economist print edition

AP

By choosing Bill Simon, California's Republicans have stayed true to their values. And probably sunk themselves

THE classic Californian story is of golden success that grows out of near-disaster—the glint in the pan of gravel, the flash of light in the dingy garage. The state's Republicans have managed the disaster part, but the nuggets are still nowhere in sight. On March 5th they decided to reject Richard Riordan, a former mayor of Los Angeles, as their gubernatorial candidate, opting instead for a conservative businessman, Bill Simon, by a margin of 49-31%; a third candidate, Bill Jones, the secretary of state (and the only Republican with a statewide office), got 17%.

Even by the sado-masochistic standards of the party's recent history in California, the decision stands out for two reasons. First, only three weeks ago, Mr Riordan looked as though he might be the party's new hope. Opinion polls showed him not only far ahead of his rivals to become the Republican candidate for governor, but also more popular than Gray Davis, the Democratic incumbent whom Mr Simon will now challenge in November.

Second, the Republicans' failures in California seem particularly stark compared with their record elsewhere. According to the polls, in the country as a whole the Republicans enjoy an almost ten-percentage-point lead. In California, the home of Reaganism and entrepreneurial America, where the Republicans held the governor's mansion for 16 years before Mr Davis was elected in 1998, the party is roughly ten points behind.

The Republicans' trouble in California is their social conservatism, on issues such as abortion and the environment. The decline of the defence industry and immigration from other states and other countries have made California, as a whole, more liberal and less white, but the Republicans have not changed. A recent *Los Angeles Times* poll found that 75% of likely voters in the Republican primary described themselves as conservative; only 29% of the total electorate accepted that description in the most recent election.

One big reason for this is the decision back in 1994, by Mr Davis's immediate predecessor, Pete Wilson, to align his party with Proposition 187, which was aimed at restricting illegal immigrants—and was hated by Latinos, a growing group of voters. And perhaps the party leadership's opposition to abortion has proved even more costly with women voters.

Mr Riordan's strength was that, while economically conservative, he was to the left of his party on social

issues. In favour of abortion rights, gun control, “domestic-partner” benefits for homosexual couples and welfare for the children of illegal immigrants, he seemed to be in tune with the independent voters who have swung towards the Democrats in recent years, particularly women and Latinos. With Mr Davis deeply unpopular because of the electricity crisis that hit California last year, Mr Riordan looked as if he might even pull in registered Democrats as well as independent voters.

How did he lose? One mistake was not to show respect to his party's conservatives. Many of them accept the need for pragmatism to beat the detested Mr Davis; but they expected Mr Riordan to court them. Instead, he concentrated on attacking Mr Davis as if he were already the candidate. His advisers included prominent Democrats such as Susan Estrich, the mastermind of the Dukakis presidential campaign. And he criticised George Deukmejian, Mr Wilson's predecessor as governor. Mr Deukmejian, a revered conservative, hit back, appearing on television to say that he would never vote for a man who had given as much money to Democratic causes as Mr Riordan has in the past.

How did Mr Riordan lose? One mistake was not to show respect to his party's conservatives

As if this were not bad enough, Mr Riordan and the Republicans then fell into a trap laid for them by Mr Davis. The Democrat unleashed a $10m advertising campaign, questioning Mr Riordan's true position on both abortion—he once described it as “murder”—and the death penalty. Mr Riordan rose to the bait, re-emphasising his liberal views on both. With the favourite knocked off balance, Mr Simon, the rich son of a former treasury secretary, began his own advertising blitz, emphasising his true conservative credentials, such as opposition to abortion and gun control.

Mr Riordan's elementary mistakes justify the critics who think that the amiable but vague mayor was ill-equipped for the governorship. Yet Mr Davis's supporters can barely disguise their glee at Mr Simon's triumph. Is Mr Simon really such a useless candidate?

In 1966, the Democratic governor, Pat Brown, intervened in the Republican primary to make sure an “extremist” won: Ronald Reagan duly deposed Brown. Thanks to the electricity crisis, Mr Davis's approval rating is only 47% among registered voters, and he has to deal with a projected budget deficit of $17 billion. Mr Simon, who drew in a bit of moderate support (notably from Rudy Giuliani), will try to concentrate on education, the state budget, transport, water and power.

But Mr Davis is bound to drive the debate back to abortion, gun control and the environment—all issues where he knows the majority is firmly on his side. He may even be keen for Mr Simon to bring up power, since the Republican thinks deregulation was not to blame—a view that (alas) few Californians share. The governor lost no time in getting stuck in on primary night, castigating Mr Simon, who only recently moved to the state, as “out of touch with most Californians”.

Mr Davis is bound to drive the debate back to abortion, gun control and the environment—issues where the majority is firmly on his side

The chances that the Republican can avoid a trouncing seem to rest on some calamity befalling the machine-like Mr Davis. That is not impossible: the state may yet have more power cuts, for instance, if the summer is a scorcher. But it is hardly a promising basis for a campaign.

California dreamin'

The irony is that, with a moderate candidate, the Republicans really would stand a chance—and not just because of Mr Davis's low ratings. The number of Democrats has been falling: at 45% of the total, Democratic registration is at its lowest since 1932. Republican registration, at 35%, is lower still. But there is now a huge block of unattached independents.

This block is being fiercely fought for. Some 70% of Latinos, for instance, currently vote for the Democrats, but their reluctance to register with that party gives the Republicans hope. Even if they could reduce the Democratic majority among Latinos to the Texas level, the Republicans would be much better off. (George Bush, who reached out to the Latinos of Texas, backed Mr Riordan.) Another powerful group of independents is in Silicon Valley, where many are sympathetic to the Republicans' economic ideas.

The Democrats are well aware of all this. Bruce Cain, whose Institute for Governmental Studies at Berkeley has analysed the rise of independent voting, points to the fact that the ruling Democrats in the state legislature have redrawn voting districts so as to increase the majorities of both parties in the

districts they already hold—and thus prolong the Democrats' legislative majority. This makes it even harder for a Republican politician to become a statewide figure. If nothing else, the Republican decision to choose an ingénu such as Mr Simon indicates a severe shortage of homegrown talent.

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The Democrats

Anti-war? Hardly

Mar 7th 2002 | WASHINGTON, DC
From The Economist print edition

The niggling at Mr Bush is more frustration than real opposition

AP

Why Daschle must tread carefully

IS AMERICA'S bipartisan support for the war on terrorism cracking? Over the past ten days the Democrats finally broke their self-imposed vow of obsequiousness on foreign policy and started to ask George Bush some tough(ish) questions.

The most prominent to break ranks was Tom Daschle, the Senate majority leader, who on February 28th questioned Mr Bush's decision to widen the war. But others have joined the fray. Robert Byrd, the chairman of the Senate appropriations committee, has refused to give the administration a "blank cheque" for further military expansion. Dick Gephardt, the House minority leader, has complained that the administration has got into the habit of failing to consult Congress over the war. Bob Kerrey, a former Democratic senator, and Jane Harman, a Californian congresswoman, have both argued that America's armed forces are already stretched too thin without adding Georgia, the Philippines and Yemen to their portfolios.

The Republicans have responded furiously. Trent Lott, the Senate minority leader, asked Mr Daschle how he dared question the war on terrorism while American troops were in harm's way. Tom DeLay, the House majority whip, said Mr Daschle's comments were "disgusting". Congressman Tom Davis accused Mr Daschle of giving aid to the enemy.

In fact, as the Republicans know, Mr Daschle was doing little more than dipping his toes in the water. For the past few months the Democrats have been desperately looking for an issue that might dent Mr Bush's astronomical popularity. So far they have been no more successful than Captain Ahab in pursuit of his whale (as Marshall Whitman, of the Hudson Institute, puts it). Mr Bush has neutralised education. The economy is turning around. Enron is producing outrage at politicians as a breed, not Republicans in particular. The Democrats can't decide what they think on taxes. Why not ask a few questions about the war, just in case that helps?

No sooner had Mr Daschle sounded off than the war grew hotter

As it turned out, the Democrats were exceedingly unlucky in their timing. No sooner had Mr Daschle sounded off than the war grew hotter. The American-led alliance engaged in some of its heaviest fighting yet, in which eight Americans were killed. The *Washington Post* revealed that the Bush administration has put a shadow government in place in case of a nuclear assault on Washington. *Time* magazine reported that, last October, American officials were briefly convinced that terrorists had got hold of a ten-kiloton nuclear device and planned to smuggle it into New York city. And there was even bad news from Europe: Tony Blair, whom some Democrats had seen as a kindred critic, hinted that Britain would support a strike on Iraq.

But, even if the Democrats' timing had been better, they would still have been taking a big risk. Most Americans regard what their government has been doing since September 11th as a necessary war of self-defence: a war that was declared by America's enemies and will be over only when those enemies are beaten. No wonder many leading Democrats (such as Al Gore and Joe Lieberman) are making it clear that they support a change of regime in Iraq, even if it means going it alone. And no wonder many leading Republicans are praying that the Democrats will try to make terrorism an issue in November's elections.

Tom Daschle has every right to discuss foreign policy and to ignore the barbs of Republican blowhards

like Mr DeLay. Congress has a constitutional duty to oversee the executive branch of government. Its members have a moral as well as a constitutional duty to ask questions about the president's decision to extend the war on terror to include men like Saddam Hussein, and about the extra $600 billion the armed forces will get in the next decade. (Indeed, one of the first to worry that the administration is over-extending itself was a Republican, Chuck Hagel.) A no-holds-barred discussion is a necessary part of winning the war.

Even so, the Democrats have to tread carefully. The merest suspicion that they are going soft on the war, or are trying to use it for partisan advantage, would be grist for Mr DeLay's mill.

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The Senate race in Minnesota

Prairie populism v suburban realism

Mar 7th 2002 | ST PAUL
From The Economist print edition

The Republicans stand a chance of unseating Paul Wellstone

AP

George and Norm, domestic partners

THE mid-west is the site of at least three battles that could help to decide which party will control the Senate after November. But none may be as hotly contested as the scrap in Minnesota. A recent poll showed a virtual dead heat between Paul Wellstone, the incumbent Democrat and arguably the most left-wing member of the Senate, and Norm Coleman, a moderate Republican. This week, George Bush came to the state to stump for Mr Coleman, whom he helped persuade to stand.

In some way Messrs Coleman and Wellstone personify the two main political forces in Minnesota. Mr Wellstone stands in the leftish tradition of Hubert Humphrey, Eugene McCarthy and Walter Mondale. Before turning to politics, he spent 21 years as a professor of political science. His two terms in the Senate have been more notable for harangues against large corporations on behalf of the “average person” (he was at it again on behalf of the steel workers last week) than for bipartisan laws, though he has got through bills helping ex-servicemen and extracting better mental-health coverage from insurers.

Prairie populism still has its admirers in Minnesota, which helps to explain why Mr Wellstone is enjoying steady support, despite breaking a self-imposed term limit by seeking a third term. The unions are firmly behind him. But Minnesota's legacy as a progressive state may be slowly giving way to a new form of pragmatic conservatism embodied by Mr Coleman.

Mr Coleman, who grew up in Brooklyn, began his political career as a Democrat. He switched parties in 1996, three years into the first of his two terms as mayor of St Paul, as he became more fond of pro-business pragmatism than of protest politics. Mr Coleman helped to bring about an urban renaissance in St Paul by offering incentives to attract new economic development, without unduly hurting the city's bond rating.

He uses all this to claim that he is the “voice at the table”, as opposed to Mr Wellstone's “voice in the wilderness”. This goes down well in the state's fast-growing suburbs, whose votes nearly tipped Minnesota into Mr Bush's camp in the 2000 presidential election. Mr Coleman had been considering running for the governorship this year, the job now held by the punchy Jesse Ventura (who has yet to declare his intentions). Mr Bush, it seems, persuaded him to run for the Senate. His visit to Minnesota raised $1.2m for Mr Coleman's campaign and another $800,000 for the state's Republican Party.

This money—and the prospect of more national-party dollars to come—will help to make the race more even. Mr Wellstone raised $4m last year (almost double Mr Coleman's tally) and he is relishing the struggle. He took his Senate seat in 1990 after a dramatic victory secured by driving tirelessly around the state in a bus.

Mr Wellstone's image as a fighter has been enhanced by a limp, which he used to claim was the product of being a wrestler while at college (a proper one, unlike Mr Ventura). Recently, however, he revealed that the limp was not an injury after all, but evidence of a mild form of multiple sclerosis. The disorder is progressive, but Mr Wellstone says his doctors have assured him that it is not yet debilitating. “I have a strong mind, I have a strong body. I have a strong heart. I have a strong soul,” he growls. “I just have a little bit of trouble with this right leg.”

Will the race turn nasty? Mr Wellstone has thrown a few punches, accusing Mr Coleman of being in Mr Bush's pocket and upbraiding him for buying campaign T-shirts made in El Salvador, possibly in a sweat shop. But Minnesotans, who put Mr Ventura into the governorship because they were fed up with politics-as-usual, dislike personal needling. Athough Mr Coleman will bash Mr Wellstone for neglecting welfare reform and prescription-drug coverage for old people, he is unlikely to mention his dodgy limb. But then he may not have to.

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Guns in American history

Just another piece of furniture

Mar 7th 2002 | WASHINGTON, DC
From The Economist print edition

A gun revisionist gets blasted

Get article background

IN AMERICA, the politics of guns is a take-no-prisoners affair—even when the guns in question are 200 years old. A scholarly magazine has just lifted the lid on one of the most original and controversial contributions to the country's gun debate for many years. It found a can of worms.

The contribution in question is a book published in 2000 called “Arming America” (Knopf), by Michael Bellesiles, a professor at Emory University. It was greeted with fulsome praise and won the Bancroft award, the main historical prize. *The Economist*, which had written about Mr Bellesiles's earlier articles, reviewed it favourably. The *Philadelphia Inquirer*, calling it the best non-fiction work of 2000, claimed that “it accomplished the astounding scholarly feat of convincing many experts in American history that a fundamental belief about our country—that the United States began as a land in which most citizens owned guns and used them—is false.” Now that claim itself appears to be false.

Mr Bellesiles argued that, until the mid-19th century, guns in America were rarer than anyone thought—rarer than in Britain at the same time. He based his claim on three sets of evidence: probate records (lists of assets at death); militia rolls (accounts of the civilian forces in which all adult men were supposed to serve); and a wealth of anecdotal evidence.

All three kinds of evidence were attacked from the start, mostly by pro-gun people or amateur historians. But now professionals have weighed in. In the new issue of the *William and Mary Quarterly*, experts on probate records, the militias and homicide in early America have reassessed Mr Bellesiles's claims and found them wanting.

The probates issue is particularly thorny. Mr Bellesiles went through thousands of probates from the years between 1765 and 1790 and concluded that, nationwide, only 14.7% mentioned guns. This was much less than other scholars had found in more limited samples. In the *William and Mary Quarterly*, for example, Gloria Main, a probate specialist at the University of Colorado, says that her survey of 604 Maryland estates found 76% with guns of some sort, making them more common than chairs.

Who is right? One problem in testing Mr Bellesiles's thesis is that his notes were destroyed in a flood in 2000. But James Lindgren and Justin Heather of Northwestern University looked at the component parts of his national average and compared them with samples from other sources (such as Ms Main's). They concluded that a national average of 14.7% is impossible. Mr Bellesiles concedes that some of his probate evidence is flawed. But he pointed out that the probate record forms only a small part of his book. The trouble is that much of his other evidence has come under attack, too.

He paints an entertaining picture of the militias as an 18th-century version of the Keystone Cops, ill-trained and militarily useless. He backs up his case with caustic comments from George Washington, no less. His aim is to show that guns, not being really suited to warfare in America before the Civil War, were pretty rare. But Ira Gruber, a military historian at Rice University, while agreeing that the militias were not heavily equipped, says they were better-armed than Mr Bellesiles claims because guns were, in fact, effective. He accuses “Arming America” of “a consistently biased reading of sources”.

Mr Bellesiles aims to show that guns, not being really suited to warfare in pre-Civil War America, were pretty rare. Other historians

If that is right, it raises two questions. First, what exactly happened? Did Mr Bellesiles get carried away by his argument, becoming blind to counter-

evidence? Or was there more to it than that?

disagree

Most professional historians doubt Mr Bellesiles's research, not his integrity. But in the *National Review* last year Melissa Seckora raised new questions. She had found, for instance, that one of Mr Bellesiles's sources—mid-19th-century probate records from San Francisco County—had been destroyed in the city's famous earthquake of 1906. Mr Bellesiles responded with differing accounts of where copies might be found, and the matter has not been settled. There are similar problems with some records from Vermont.

He will now have to defend his work before his peers. His university department asked him to respond in the *William and Mary Quarterly*, which he duly did, defending some claims, and qualifying others, notably the probate record. And, partly at his request, Emory University has started a formal inquiry into allegations of misconduct.

There remains the bigger question. Is anything left of his basic thesis, that guns were rare before the Civil War? On the face of it, not much. The bloody battles of 1861-65 made guns more accurate and, perhaps, cheaper too (though Randolph Roth of Ohio State University contests Mr Bellesiles's claim that they were expensive before the war). It may even have made them more widely available, though if half of all households had guns before 1800 the increase in ownership cannot have been all that sharp.

Yet the embattled historian may still be onto something. “Arming America”, he says, is concerned “with culture, not the number of guns in America”. The book says there was little or no gun culture before the Civil War. That claim is in doubt. But if you think of the question not as “When did the gun culture start?” but as “What was the role of guns in American culture?” then his book contains a mass of evidence that, in the 18th century, guns did not have the almost mythic, nation-defining role they came to play later. It is possible that they were treated merely as pieces of furniture—such as the chairs which, according to Ms Main, were less common than guns.

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Leaving Condit country

Mar 7th 2002
From The Economist print edition

AP

THERE'S a first time for everything. Until this week, Gary Condit had not lost an election. For 30 years the Democrat breezed through a political career which took him from the city council of Ceres, California, to a safe congressional seat. But all that ended on March 5th, when Mr Condit, haunted by his association with Chandra Levy, a Washington intern who went missing last year in suspicious circumstances, was comprehensively buried in the Democratic primary in California's 18th district. Dennis Cardoza, who used to work for Mr Condit, took 55% of the vote; his former boss got only 37%.

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Western land management

Subsidised cow chow

Mar 7th 2002 | SHERIDAN, WYOMING
From The Economist print edition

Is there an alternative to expensive grazing subsidies?

HERE'S what it takes to fulfil the conditions for a federal land-grazing permit. Buy some cattle. Buy a branding iron. Brand the cows. Truck the cattle to the federally-owned land that you have leased. Let them mooch around for ten minutes or so, then load them back into the truck. Sell the cattle. Sell the branding iron.

This, in fact, is precisely what an Idaho-based conservation group plans to do in order to comply with the bewildering grazing regulations of the United States Forest Service. The Western Watersheds Project, whose aim is to restore wet riparian habitat to the west's arid state- and federal-owned lands, bought a ranch that came with a 40,000-acre grazing allotment on the Challis National Forest in Idaho. The group argued that the location in the Salmon River watershed made it a prime habitat for wildlife, and far too valuable to waste on grazing. But the Forest Service refused. It insisted that, in order to validate its permit, Western Watersheds must continue to use the land for grazing.

For years, environmental groups have been trying to reduce the number of cattle grazing on the 270m acres of land owned by the Forest Service or the Bureau of Land Management (BLM). But the efforts of grazers' lobbying groups and politically-connected landed families have seen to it that federal regulations remain pretty much intact. The average charge for federal land is $1.43 per animal unit month, or AUM (ie, the amount of forage needed to sustain a cow and a calf for one month). On private land it is closer to $11.

Water, water nowhere

Very slowly, however, the balance has tilted. In the endless battles over enforcing the 1973 Endangered Species Act, it has become clear that riparian zones in the west need protection from livestock. These streams and wetland areas occupy less than 1% of the surface area of federally-owned western lands. Yet few creatures, large or small, can survive without them. Even stockmen, who hate the act, have grudgingly come to realise that retiring grazing leases is preferable to waging costly environmental battles in court—all the more so as green groups are prepared to buy them out of those leases.

Such buyouts make particularly good sense for federal grazing leases in national parks and recreation areas (which are exempted from the usual land-use conditions). In 1996, Congress allowed permit-holders in the Great Basin National Park in Nevada to donate their grazing permits to the Park Service (and deduct the money from their tax bills). In 1999, three permit-holders within Mt Moriah Wilderness, also in Nevada, retired their leases in exchange for compensation from a number of conservation foundations.

Perhaps no group has been more successful in arranging the retirement of leases than the Grand Canyon Trust. Most of its conservation work is in the Colorado plateau, home to the greatest concentration of national parks and monuments in the country. Since 1996, the trust has retired about 750,000 acres of federal grazing leases. The trust pays a one-time fee—on average about $75 per AUM—to take the lease out of circulation, more or less permanently. Bill Hedden, a conservation director at the trust, stresses that agreement among all parties is essential to brokering a successful deal. “Generally, the rancher comes to us. We don't go to him.” They also need the Forest Service and the BLM to agree that grazing on the allotment is not in the public interest.

Since late 2001 a consortium of conservationist groups called the National Public Lands Grazing Campaign has taken the debate to another level. Developing an idea that has been under discussion by

environmental groups for several years, they want the federal government to buy out permit-holders for $175 per AUM. If all 27,000 public-land ranchers were willing to sell up, it would cost the federal government $1.5 billion. A rancher in charge of 300 head of cattle would stand to make around $262,500. This may seem generous, but federal grazing subsidies currently cost taxpayers upwards of $460m every year. Within four years, it would look like a good deal.

Grazing, along with hard-rock mining, represents the last bastion of government-subsidised extraction of commodities from public lands. The American taxpayer deserves a viable alternative.

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Alternative ranching

Of bison men

Mar 7th 2002 | CLEARMONT, WYOMING
From The Economist print edition

It's tasty, it's safe and it's cheap

RICHARD BUMBACA, a bison rancher, has three hunters with him this morning. They are not there for the novelty of shooting a buffalo. They're looking to buy some cheap bison meat. With drought and buffalo prices at record lows, Mr Bumbaca is just doing his best to make ends meet. Three years ago his buffalo calves fetched $2,500 apiece; last autumn's animals went under the hammer for $300. “They got the cart in front of the horse,” Mr Bumbaca says of the industry. “All these rich folks got in the buffalo ranching business before they established a market.”

Around the country, and especially at the North America Bison Cooperative in New Rockford, North Dakota, freezers are full of tonnes of unsold buffalo meat. Encouraged by Senator Kent Conrad (of North Dakota), the Department of Agriculture has bought 2.3m lbs (1m kilos) of bison burgers over the past three years, ostensibly to be sold for school lunches and poverty-reduction programmes.

Dave Carter, of the National Bison Association in Denver, points out that for a public much exercised by deadly microbes and meat-borne bugs, bison products are the picture of integrity. He points to a recent Colorado State University study revealing that the average four-ounce hamburger patty comprises beef or fat tissue from between 55 and 1,082 animals. With the bison equivalent, though, it is possible to identify the particular ranch the meat came from.

Bison producers are now getting a further boost from the biggest buffalo rancher of all: Ted Turner. The media mogul, who boasts a 27,000-head herd of bison, has teamed up with a restaurateur, George McKerrow, to set up a chain called Ted's Montana Grill. It will serve chicken, steak, beer and, of course, bisonburgers.

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Lexington

A very big shoe to fill

Mar 7th 2002
From The Economist print edition

Time to groom an heir for Alan Greenspan

THE Bush administration prides itself on its forward thinking. Since September 11th scores of officials have been packed off to secret locations to form a back-up government in case Washington is hit by a nuclear attack. Karl Rove, the White House's chief political planner, spent years preparing the 2000 campaign; he already, it is said, has the road to the 2004 election mapped out. How odd, then, that Team Bush seems to have lapsed on what is arguably its most important economic task: preparing America for a successor to Alan Greenspan.

Don't panic. The departure of the Federal Reserve's chairman is probably not imminent. Although the financial markets have lately been rife with rumours about his retirement, the same thing has been said countless times before. America's top central banker has given no hint of an intention to go, and appears to be in robust health. His tennis game is vigorous, and his ability to answer questions at a tedious three-hour hearing in the Senate—enough to test anyone's stamina—seems undiminished. Anyone who knows Mr Greenspan finds it hard to believe that he is about to walk away from a job he clearly loves.

Nonetheless, the Fed's boss—who celebrated his 76th birthday on March 6th—is no spring chicken. His age, some say, is gradually beginning to show. More important, the political calendar suggests that a retirement, if it does come, might come sooner rather than later. Mr Greenspan's fourth four-year term finishes in June 2004, just before the presidential election, a tricky time for George Bush to name a replacement. Although the White House would love Mr Greenspan to stay on into a fifth term, prudence suggests some contingency planning.

The first challenge is to get beyond the idea that Mr Greenspan is irreplaceable

The first challenge is to get beyond the idea that Mr Greenspan is irreplaceable. He has spent nearly 15 years at the helm of the Federal Reserve. After steering the economy through the 1987 Wall Street crash and the 1998 collapse of Long-Term Capital Management, and after presiding over the 1990s boom, he has become a semi-divine figure. A whole generation of investors knows no other Fed chairman. And his influence goes well beyond interest rates. Politicians from both parties seek his blessing on everything from tax cuts to accounting rules. The bursting of the dotcom bubble has splashed a bit of dust on his reputation, but Mr Greenspan is still an exalted figure. Any successor Mr Bush names will seem wanting in comparison.

That is true, but not unusual. It is easy to forget that Mr Greenspan's predecessor, Paul Volcker, was once also thought irreplaceable. After famously slaying double-digit inflation in the early 1980s, Mr Volcker, too, was a giant of economic policy. At 6 feet 7 inches, he towered, literally, over Ronald Reagan's economic team. His actual power was probably less absolute than Mr Greenspan's (he held the

job for a shorter time, he was less able to dominate a central-bank board full of Reagan appointees, and he had a more fractious relationship with the administration). But what people saw was the same: Mr Volcker was a giant among pygmies. When Mr Greenspan's appointment was announced, many wondered whether he was up to the job.

But at least he was regarded as the most plausible candidate. This newspaper said at the time that “most financial folk agree that, if they cannot have Mr Volcker, then Mr Greenspan is the best man for the job.” With decades of experience in running his own economic consultancy, Mr Greenspan was well-respected on Wall Street. A senior job in the Ford administration had left him with plenty of political experience and connections. In a series of surveys of Wall Streeters conducted by Drexel Burnham Lambert (yes, it was that long ago) between 1983 and 1986, Mr Greenspan regularly ranked first or second on the list of people to replace Mr Volcker.

My God, why have you forsaken me?

Today there is no clear front-runner, nobody who commands such respect both on Wall Street and in the White House. As the rumours about Mr Greenspan's departure have reappeared, the list of candidates has grown longer. A recent poll of Wall Street analysts by the Blue Chip Economic Indicators group put John Taylor, under-secretary for international affairs at the Treasury, in first place. His name was followed by those of Bill McDonough, president of the New York Federal Reserve, Robert Rubin, Bill Clinton's treasury secretary, and Larry Lindsey, Mr Bush's top economic adviser.

The list of post-Greenspan candidates has grown longer, and includes two Democrats

The striking aspect of this list is that two of these people are Democrats. In the Clinton era, Messrs McDonough and Rubin would have been weighty candidates. But it is hard to see Mr Bush offering the job to either of them—particularly to Mr Rubin, who has savaged the administration's tax policy. As for the Republicans, Mr Taylor topped the Wall Street list because of his powerful academic reputation. He is a leading analyst of monetary policy, inventor of the “Taylor Rule”, a good rule-of-thumb for setting interest rates. But few people on Wall Street know him personally, and in Washington he has not as yet made a particularly distinctive mark in the current Bush administration. That is not Mr Lindsey's problem: he has played a major role in setting fiscal policy. But his partisanship is a minus in the financial world. Despite his experience as a governor of the Federal Reserve, he is increasingly seen on Wall Street as a politician, not an economist.

In short, neither Mr Taylor nor Mr Lindsey enjoys the reputation Mr Greenspan had in 1987. The Greenspan era may continue for several more years, but Mr Bush would be foolish to count on it. The financial markets seem to have indulged his decision to choose as his treasury secretary Paul O'Neill, a gaffe-prone businessman, as a little joke at their expense (not least because the money men, like everybody else, still place their trust in Saint Alan). A mistake with the Greenspan succession would be much more serious.

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Argentina

Duhalde's survival struggle

Mar 7th 2002 | BUENOS AIRES
From The Economist print edition

AP

Approval of the budget has given the president a breathing-space. Now for the IMF

Get article background

IN THE two months since Eduardo Duhalde became Argentina's president and devalued the peso, his government has made heavy weather of trying to set the economy on the path to recovery. But this week saw two milestones, of sorts. A team from the IMF arrived in Buenos Aires for the start of what may be lengthy negotiations over a new loan programme. And Mr Duhalde at last got the country's Congress to approve a budget, cutting spending by 14% from last year, which involves some belt-tightening by provincial governors.

Both these events, in different ways, strengthen Mr Duhalde's faltering grip on the presidency. Indeed, he felt emboldened to organise a mass demonstration, with thousands of supporters bused in from his province, to mark the start of the congressional year on March 1st. Even so, his government has little to celebrate yet. It must somehow try to satisfy the IMF, political leaders and an angry and impoverished population. And none shows much sign of trusting Mr Duhalde.

The government needs the backing of the IMF to have any hope of floating the exchange rate successfully. But, having lent $28 billion to Argentina last year, some of it against the better judgment of the United States Treasury, the IMF is not in forgiving mood. Instead of Claudio Loser, an affable Argentine who heads the Fund's Latin American department, this week's mission is being led by Anoop Singh in a new post of chief troubleshooter.

Having lent $28 billion to Argentina last year, some of it against the wishes of the US Treasury, the IMF is not in forgiving mood

The first issue is Argentina's notoriously leaky public finances. Fund officials had made it clear that a deal on provincial finance and approval of the budget were needed before talks could begin. But these are unlikely to be enough to unlock the loans of some $10 billion by the Fund (and with them, further money from the development banks). Mr Duhalde's deal with the governors temporarily cuts revenue transfers from the centre, but sees the national government take on the provinces' debts, and offers no penalties if they fail to hit tighter deficit targets. In short, it does not tackle the overall restructuring of provincial financing that the IMF wanted.

Neither does the budget stand much scrutiny. It forecasts inflation of 15% this year and a 5% fall in GDP. Both predictions look optimistic. So does a projected fiscal deficit of 3 billion pesos, if tax revenues continue to slump (in February, they fell by 20% compared with the same month last year). A windfall

tax on exports announced this week should help shore up the government's finances, but has annoyed business. As well as commitments on monetary policy, the IMF also wants Argentina to start talks with its foreign creditors and present proper proposals to deal with the banking system's problems.

No Argentine politician, including Mr Duhalde, enjoys trust or approval nowadays

Jorge Remes Lenicov, the economy minister, seems committed to taking the necessary measures. But is Mr Duhalde? At the start he talked like a populist, and some of his officials seem happy to blame Argentina's problems on foreign banks and businesses. Nor is the president in a strong position to impose unpopular measures. Having been chosen by Congress after two predecessors had been overthrown by rioting, Mr Duhalde was always going to have to earn popular legitimacy with results. In fact, no Argentine politician enjoys trust or approval nowadays. Ricardo Rouvier, a pollster, says that fewer than 20% of Argentines believe that Mr Duhalde is capable of managing Argentina's crisis—but that is more than any other politician scores.

In Congress, Mr Duhalde has the backing of both main parties, but it is not unqualified. His own, internally divided, Peronist party supports him mainly out of fear that, were he to fall, it might collapse with him. Raul Alfonsin, the leader of the Radicals, has recently acted as the president's main cheerleader, but that is because he is desperate to avoid a new election in which his party, branded with the stigma of the hapless de la Rua government, would be slaughtered.

Before the deal with the provincial governors, Argentines were starting to wonder aloud whether Mr Duhalde would survive until the presidential election fixed for September 2003. Businessmen were reported to have held hush-hush meetings with army officers. The army, starved of funds for a decade, is a shadow of the force that tyrannised Argentina in the 1970s. Its generals are widely said to lack any appetite for power.

Might they yet find power thrust upon them? For now, Mr Duhalde seems to have won himself a breathing-space. But there is a long way to go before it can be said that Argentina's economy, let alone its political system, is on the mend.

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Venezuela

On troubled waters

Mar 7th 2002 | CARACAS
From The Economist print edition

Venezuela's state oil company refuses to serve Hugo Chavez's revolution

AP

What might he set rolling?

IN THE quarter-century since its nationalisation, the Venezuelan oil industry has remained relatively immune to the party-political infighting and cronyism that have done so much damage to the rest of society. That is just as well, since the state corporation, Petroleos de Venezuela (PDVSA), is nothing less than the engine-room of the national economy. It provides roughly 80% of foreign earnings and about half the government's revenues, not to mention a subsidy that allows Venezuelans to enjoy probably the world's cheapest petrol, at around seven American cents a litre.

President Hugo Chavez has always resented the relative autonomy of this "state within a state". In the three years since the populist former army officer came to power, he has sought to place Latin America's largest company at the service of his "Bolivarian revolution". His efforts have always foundered on trade-union strength and a corporate culture that stresses professionalism and meritocracy. Now, however, he has launched an assault that has been met with an unprecedented revolt at all levels of the company.

Gaston Parra, the leftist academic who recently became chairman of PDVSA, is the fourth Chavez appointee to the post. His predecessor, Brigadier Guaicaipuro Lameda, "went native" and eventually balked at the government's sacrifice of the company's commercial viability to short-term fiscal convenience. PDVSA has, for example, been obliged to store overproduced oil, on which it has paid royalties but for which it has not been paid. Some $300m-worth now sits in tanks, while the corporation has had to borrow $500m.

Moreover, as Mr Lameda puts it, though the company's accounts are nominally solid, "much of the money [on the credit side of the balance-sheet] is elsewhere." The overdue debt is mainly in the Venezuelan public sector: the largest debtor of PDVSA Gas, for instance, is the state electricity board, Cadafe.

Mr Parra was among those responsible for a controversial new hydrocarbons law, seen by private-sector sources (and Mr Lameda) as a virtual death-blow to prospects for foreign investment in the industry. The professor, who has no managerial experience, is also an enemy of PDVSA's independence. The directors of the new board he chairs have leapt as many as six or eight levels in the hierarchy, and are thus regarded by many as unprepared for the task of running the company.

On the day the board was sworn in, senior managers held an extraordinary press conference at which, among other things, they accused the government of "pushing the company to the verge of operational and financial collapse". Mr Chavez had already dismissed their complaints, saying that anyone who was discontented could "go and get a job with Shell or BP".

At first, the managers stressed that they would stay in their posts. But there appeared to be a real danger that, without government concessions, the whole industry could be brought to a halt by a strike. The economy is already battered by a fall in the oil price. A full stoppage of the industry would cost some $45m a day in lost export revenue alone.

The oil unions have never achieved a complete stoppage, because management-level employees operate a contingency plan. But there is no such plan to deal with a strike by both unionised labour and the (soon-to-be-unionised?) management. With the main trade-union confederation already threatening a

general strike against Mr Chavez, his best bet would seem to be to make concessions. As yet, he has no intention of doing so. But he may, in the end, have no choice.

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The Bahamas

Simmering discontents

Mar 7th 2002 | NASSAU
From The Economist print edition

A government both too clean, and not clean enough

OUTSIDE the headquarters of the Progressive Liberal Party (PLP) on the night of February 27th, the roars of the crowd were deafening. Was the Bahamian opposition back in power after ten years? Not yet. The general election will be in April or May. But the PLP's No campaign had just defeated Hubert Ingraham's governing Free National Movement in a referendum on five proposed constitutional amendments.

The referendum proposals seem innocuous enough: guaranteed constitutional equality for women, a higher retirement age for judges, and so on. Indeed, the opposition voted for them in parliament in December and January. But then it changed its mind, saying that neither parliament nor the voters had had time to look at the small print. The Bahamas Christian Council, a formidable lobby, came out on their side.

On the face of it, Mr Ingraham's Free National Movement should be heading for a third clear victory. In 1992 the islands' image was tarnished by money-laundering, drug-trafficking and corrupt business deals. Since then, foreign investment has poured in, and the economy has boomed. Some 4m tourists visit each year, and Bahamian offshore banks and mutual funds handle perhaps $350 billion of other people's money.

But to many Bahamians the government now looks arrogant and out of touch. At an FNM convention held last August to choose Mr Ingraham's heir-apparent, the party establishment tried a mite too hard to ensure the narrow victory of its favoured candidate, “Tommy” Turnquest. From a party that came to power promising more openness, voters expected better behaviour.

The FNM is also too keen to please foreign investors, says the PLP. Since 2000, opponents say the FNM has fallen in too readily with the wishes of the OECD's Financial Action Task-Force, which is pressing for tighter controls on money-laundering. A raft of new financial laws, which took the Bahamas off the task-force's blacklist last June, meant that 55 out of 410 offshore banks and trust companies had their licences revoked, and offshore-company registrations fell by 70%. As a result, much dirty business was lost.

A PLP victory would not necessarily mean a return to the 1980s, when Sir Lynden Pindling was prime minister. His successor as PLP leader, Perry Christie, resigned from Pindling's cabinet in 1985, along with Mr Ingraham, when it was revealed to be tainted with drug-trafficking. The two men once shared a legal practice, too. The prime minister will have to work hard to beat his old law partner now.

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Air pollution in Latin America

The right to drive or the right to breathe?

Mar 7th 2002 | SAO PAULO AND MEXICO CITY
From The Economist print edition

Politicians have taken some steps to cut deaths from dirty air, but more are needed

IN 1554, a band of wandering Jesuits, after sweating through southern Brazil's forested coastal hills, stopped by a river on the high Piratininga plateau and, delighted at its fresh, cool air, founded the city of Sao Paulo. Were they to return now, for much of the year they would find a grey-brown smog shrouding a metropolis of 18m people and 6m vehicles. The foul air kills thousands of people a year and inflicts chronic illness on countless others.

Mexico city has long been notorious for its polluted air. Fuel burns less efficiently at high altitude, and thermal inversions mean that the surrounding mountains trap a layer of cold air above the city, preventing the dispersal of fumes. But the surge in car ownership throughout Latin America since the 1970s means that Sao Paulo and other Latin American capitals are no longer far behind. Though at lower altitudes, both Sao Paulo and Santiago suffer from thermal inversions too.

The result is a big health problem. The World Health Organisation estimates that just one of the pollutants emitted by vehicles—suspended fine particles—causes 200,000 deaths a year in the region's cities, most of them among the poor.

Governments have taken some clean-up measures. These have gone furthest in Mexico city. Heavy industry has been moved outside the city, power plants switched to natural gas, and standards for vehicles tightened. Since 1991, the air has been getting cleaner, despite the city's vehicle fleet growing at around 6% a year. Even so, ozone and suspended particles are frequently above the permitted limit. The problem is not so much the number of cars as their age. Because of tighter regulations, a Mexican car made since 1997 pollutes up to 100 times less than one made before 1995. But two-thirds of the city's vehicles are more than ten years old.

In Mexico city, the government has taken some clean-up measures. Sao Paulo, by contrast, has scarcely begun to act

By contrast, Sao Paulo has scarcely begun to act. The vehicle fleet in South America's largest city has risen sixfold since 1980. Despite cleaner technology, its ozone levels have changed little since then. Under a government programme to cut fuel imports, Brazil dilutes petrol with alcohol: this reduces emissions of carbon monoxide but increases those of formaldehyde, whose health effects are noxious but unmeasured, according to Alfesio Braga, a paediatrician from Sao Paulo who also studies pollution. He says his caseload of wheezing children gives no indication that things are improving.

The health benefits of cleaning up are clear, if modest. A study last year found that a 10% cut in ozone and particles would save 37,000 lives in Mexico city and 13,000 in Sao Paulo by 2020. To achieve this, it suggested a handful of cheap, simple measures, such as better traffic management. One of the authors, Nelson Gouveia, an epidemiologist at the University of Sao Paulo, says the study may underestimate the lives saved: air pollution also has an as-yet-unmeasured effect on blood thickness and may thus be causing heart disease. Some such measures might pay for themselves. Another study found that converting Sao Paulo's buses to run on natural gas would, apart from being economic in itself, save perhaps $15m in health costs.

Pollution control has gone furthest in Santiago, Chile's capital

Pollution control has gone furthest in Santiago, Chile's capital. In 1996, the national government created “tradable permits to pollute”, which industrial firms can buy and sell. Research elsewhere has shown that these reduce the total amount of pollution created. The government is now trying to extend them to vehicles. But it is hard, as Mexico has found, to devise policies that do not

penalise poorer motorists, who tend to have the oldest vehicles.

All three cities try to cut both pollution and traffic congestion with schemes in which each car is banned for one day a week. But the main effect of this has been to encourage the middle classes to buy a second car and, sometimes, to delay scrapping an old vehicle. Furthermore, a popular revolt against Sao Paulo's scheme—its citizens value their right to drive above their right to breathe—led to it being restricted to peak hours only. In Mexico city and Santiago, most cars with catalytic converters are exempted from the ban.

Since 1994, Sao Paulo's city council has been trying to introduce regular emissions inspections for vehicles. These have been stalled by legal rows. Mexico city has long had such tests, but drivers have taken to bribing the vehicle inspectors. After city officials strengthened checks on the inspectors last year, the fail rate shot up from 15% to 25% of cars tested.

Public transport can be a culprit as well as a solution. Much of Mexico city's pollution is caused by its 100,000 Volkswagen Beetle taxis, whose emissions can be 50 times those of a modern compact car. The government's new clean-air plan aims to persuade their owners to replace them, and to get the owners of minibuses to switch to gas-fuelled vehicles. But the government has dropped a plan to finance the trade-ins by bringing back an “environmental” tax on fuel, abolished for political reasons in 1997. Chile's government bought and retired a batch of the capital's smoky old buses in the 1990s, but this may be too expensive to repeat. A cheaper option, suggests Luis Cifuentes of Santiago's Catholic University, would be to include pollution targets in the bidding for bus operators' licences.

Better public transport, tighter emissions standards and wider use of clean-air technology could all help. But in a car-mad region, few politicians are likely to risk driving cars off the road or increasing the cost of motoring.

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Pakistan

Not a pariah, a friend

Mar 7th 2002 | LAHORE
From The Economist print edition

Six months on from September 11th, Pakistan's president looks secure

AP

Get article background

PAKISTAN's president, General Pervez Musharraf, counts his decision to support the international war against terrorism after September 11th as the most difficult of his life. It meant not only abandoning a five-year old policy of support for the Taliban government in Afghanistan, but also providing military bases on Pakistani soil for the American attack on al-Qaeda's terrorists and their Taliban hosts. In consequence, another hard decision had to follow: whether to crack down on the militant fundamentalists inside Pakistan who support the Taliban, or al-Qaeda, or both, and who desperately want to oust the pro-American government in Pakistan.

In taking these decisions, General Musharraf had to sweep aside resistance to an about-turn on Afghan policy in the Inter-Services Intelligence directorate (ISI) that oversees security policy, as well as in the armed forces' general headquarters. First to be sacked was General Mahmood Ahmad, the ISI chief who failed to persuade the Taliban to ditch al-Qaeda and save themselves as well as Pakistan's foreign policy. Then came the turn of the deputy chief of army staff, General Muzzafar Usmani, an Islamist, who favoured a less pro-American stance. Both were personally close to General Musharraf, having jointly carried out the coup against the government of Nawaz Sharif in October 1999 after Mr Sharif sacked General Musharraf while he was out of the country.

These brave decisions have proved to be a boon for Pakistan. As a reward, governments and international banks have rescheduled $12.5 billion in Pakistani debt over 30 years, reduced tariff barriers against Pakistani textile exports to America and the EU, and governments have nudged donors, including the IMF, the World Bank and the Asian Development Bank, to provide soft loans for restructuring the economy and boosting Pakistan's foreign-exchange reserves.

America has also removed all the sanctions against Pakistan (imposed progressively since 1990, when the government in Islamabad was deemed to have crossed the line into nuclear proliferation). It has provided about $600m in economic assistance for poverty alleviation, promised to try to write off $1 billion in bilateral debt, allowed the Pakistani army to buy military parts and spares for its ageing American weapons systems and restored military-to-military contacts. Before September 11th, Pakistan's economy was in a hole, with reserves of barely $3 billion and big trade deficits in goods and services. Now things are looking brighter—reserves are $5 billion or more, foreign payment pressure has eased significantly and international credit ratings have risen. The rupee has even appreciated a bit against the dollar, while the Karachi stockmarket is up a thumping 45% on its pre-September level.

But it is General Musharraf's personal stock at home and abroad that has risen most. At the time of the 1999 coup, the world regarded him as a usurper and shunned his country as a pariah. Apart from the Gulf states, only such countries as Libya, Myanmar and Malaysia were ready to welcome him as a state guest. Every international visitor who at that time descended on Pakistan, including Bill Clinton in March 2000 for just five hours, seemed interested only in demanding a timetable for a rapid return to democracy.

Now, in a remarkable reversal, General Musharraf looks more like a statesman than a mutinous soldier. Last month he was feted in Washington by President George Bush, who described him as his “friend”:

before the American presidential election of 2000, Mr Bush had been unable to remember his name. Much the same sort of treatment was accorded the general during brief stopovers in London and Paris. Next week, he will visit Japan, where he will attend a luncheon given by the emperor, a rare honour considering that Japan became Pakistan's severest critic after it tested its nuclear bombs in May 1998. Meanwhile, a string of bigwigs, from the British prime minister to the German chancellor, as well as the American secretary of state, have been trooping in and out of General Musharraf's house in Rawalpindi cantonment. The topic of democracy gets barely a mention these days. Only India, piqued that its efforts to cosy up to America have been trumped, is immune to the general's charms.

Yet the new, anti-fundamentalist and pro-western Pakistan and its secular architect are not yet out of the woods. The threat of a fundamentalist backlash remains real enough, despite mass arrests of militants and extremists. In recent weeks, a spurt of sectarian warfare has occurred in urban areas, in which over two dozen people have been shot. The kidnapping and gruesome killing of Daniel Pearl, an American journalist, is another indication of the defiance of the fanatics. General Musharraf's own security has had to be intensified.

There are other worrying signs, too. General Musharraf recently quoted a verse from the Koran which implied that divine intervention had catapulted him to the top and had ensured him success in all his past, present and future endeavours. Even devout Pakistanis tend to be wary of such observations. Another military coup-maker, General Zia ul Haq, suffered from much the same sort of delusion, and he remained in power for years longer than he had promised before he perished in a plane crash in 1988. Not to be outdone, Mr Sharif, Pakistan's former prime minister, had been set to have himself officially declared as an Amir ul Momineen (Leader of the Faithful, a title also used by the Taliban's leader, Mullah Omar) shortly before he was booted out by General Musharraf.

All this has ominous implications in the context of the “true democracy” that Pakistan's military leaders say they intend to usher in next October, when a general election is still scheduled. Controversial constitutional amendments have already been decreed to accommodate a new institutional role for the armed forces in politics, and the general will be staying on as (unelected) president. Democracy is still a distant dream in Pakistan.

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India's Hindus and Muslims

After the slaughter, what hope?

Mar 7th 2002 | DELHI
From The Economist print edition

The religious violence in India is tied to a fast-approaching deadline

Get article background

AP

The cost of temple frenzies

TEN years ago in December, a mob of Hindu activists, in the presence of several men who are now ministers in India's government, tore down a mosque in Ayodhya to make way for a temple on what they hold to be the birthplace of the god Ram. The Ramjanmabhoomi ("Ram's birthplace") campaign transformed India. Its popularity helped the rise of the Hindu-nationalist Bharatiya Janata Party (BJP), which now leads the governing coalition in Delhi. Its divisiveness triggered clashes between Hindus and Muslims in which thousands died. It raised incendiary questions: do India's 120m or so Muslims truly belong in a land of 820m Hindus? Does faith pre-empt the law?

Now the next step of the Ram movement—the proposed construction of a temple where the mosque stood—has brought the violence and the questions storming back. Trouble started on February 27th with the burning to death by a Muslim mob of 58 Hindu pilgrims, many of them women and children, returning by train from Ayodhya to their homes in Gujarat, a rich western state. That atrocity triggered worse: revenge killings of Muslims by Hindu mobs, especially in Gujarat's commercial capital, Ahmedabad. More than 600 people have so far died.

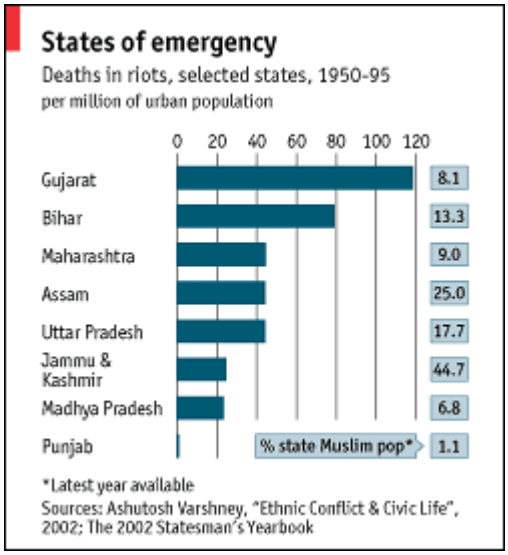
The violence may not be over; some Muslim group may retaliate, perhaps with a bomb. But India does not look set to repeat the serial eruptions of the early 1990s. Ramjanmabhoomi, though popular, does not stir the masses now as it did then. It did not, for example, help the BJP win last month's election in India's biggest state, Uttar Pradesh, where Ayodhya is. The BJP is no longer a fringe party with little to lose. It wields power in Delhi in concert with 18 other parties, some of which depend on Muslim support. It is now struggling to find a formula that will satisfy two sorts of allies, the would-be builders of the Ram temple, who have promised to start work on March 15th, and political parties loth to tamper with the status quo.

The flames of Gujarat seem to suggest irreconcilable differences between India's Hindus and Muslims, but that is misleading. Certainly, a Hindu hard core has not recovered from memories of Muslim assaults on India that stretch back at least to Mahmud of Ghazni, an 11th-century raider who killed Hindus and desecrated temples with extreme cruelty. Pravin Togadiya, the international general secretary of the Vishwa Hindu Parishad (World Hindu Organisation, or VHP), which leads the Ramjanmabhoomi movement and has ties to the BJP, likens the alleged Muslim demolition of the original temple in Ayodhya 500 years ago to the destruction of the World Trade Centre. Today, he says, "the Muslim mass is supporting *jihad*."

But the map of Hindu-Muslim violence is spotty, which suggests that something other than a clash of civilisations is going on. While parts of Gujarat burned this month, most of India, even the areas with most Muslims, remained calm. The pattern points to other causes, some of which are hardly less troubling. Disturbed areas are often cursed with politicians who exploit violence for electoral gain and with institutions, such as the police, that have been corroded by politics and patronage.

Ashutosh Varshney, a professor at the University of Michigan, points out in a new book that levels of communal violence vary widely among Indian states (see chart). Even within violence-

prone states such as Gujarat some areas erupt while others with similar mixes of Muslims and Hindus remain peaceful. Mr Varshney argues that calm areas are kept so by strong non-governmental institutions that cross communal lines. Thus, relatively tranquil Surat boasts a textile industry that has given rise to integrated business associations; in violent Ahmedabad Muslims are all but absent from today's business and professional guilds.



There, the ugliest communal passions have free rein. Hindus and Muslims have long been afraid to move into each other's areas. Their mistrust has been stoked by the rise of the BJP, which has an absolute majority in the state's legislative assembly. The chief minister, Narendra Modi, was until recently a full-time member of the RSS, a Hindu-nationalist umbrella group to which both the BJP and the VHP belong. When Muslims killed nearly 60 Hindus in Godhra, 150km (95 miles) away, an old machine kicked into gear. According to police reports, local leaders of the VHP incited Hindu mobs to attack Muslim houses and businesses, slaughtering hundreds of people. Mr Modi denies charges that the police were slow to act or that the government favours Hindus. Hindu victims of “terrorism”, however, are to get twice the compensation of 100,000 rupees—about $2,000—given to the mostly Muslim victims of “communal violence”.

The BJP-led government in Delhi has less to gain from polarisation. It is searching for a compromise on Ayodhya that will satisfy the VHP (and enthusiasts in its own ranks) without triggering still more violence. On March 7th, the VHP seemed to have made a concession by agreeing to accept the eventual verdict of a court on the ownership of the Ayodhya plotO In exchange though, it wants the government to return to it control of land immediately next to the site by June, and to be allowed to conduct a ritual on that land on March 15th. This might well prove too much for Muslims to accept. As the deadline approaches, the government is still on the hook, and India is still on edge..

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Afghanistan

So much still to do

Mar 7th 2002
From The Economist print edition

Hamid Karzai is struggling to unite his fractured country

EPA

Policing Afghanistan

SIX months on from September 11th, no country has been changed more than Afghanistan. The Taliban and al-Qaeda have been driven out: the heavy fighting that unexpectedly flared up this week serves as a reminder that the task is not quite as complete as the world has been encouraged to assume, but the final outcome cannot be in any doubt. Unfortunately, uncertainty remains as to what will happen when the last of the fugitives has either surrendered or died at the hands of America.

Hamid Karzai, Afghanistan's interim prime minister, is by all accounts a competent leader. Already, a degree of normality is starting to return to much of the country after the excesses of the Taliban's warped programme of Islamisation. But it is also evident that Mr Karzai's writ is circumscribed. He finds it easier to fly around the world than around his own country, and Afghanistan remains dangerously unstable. Despite Mr Karzai's impassioned appeals, the international coalition, notwithstanding its promises not to abandon Afghanistan as it did ten years ago, has so far refused to beef up its limited security presence in the country.

Only the capital Kabul benefits from the attentions of the International Security Assistance Force, and even ISAF was unable to save the country's aviation minister from assassination by his enemies last month. The Americans have in the past explicitly ruled out sending troops to help keep the peace (as opposed to troops to fight the remnants of their own enemies, the Taliban and al-Qaeda), and Britain has indicated that it will not increase its limited presence. What is needed is an extension of ISAF's remit to at least the five or six biggest cities. That may now happen, but it should have been done much earlier.

The lack of a powerful international presence is encouraging local warlords to stake out their territories: the two most powerful, Ismail Khan in Herat in the west and General Rashid Dostum in Mazar-i-Sharif in the north, run what are little more than private fiefs. Mr Karzai, lacking any troops of his own or an international force, was this week reduced to having to plead with General Dostum and other warlords in the north to rein in their men, who have been accused of a series of attacks on Pushtuns, the main ethnic group in Afghanistan.

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China's future

A dampened blaze

Mar 7th 2002 | BEIJING
From The Economist print edition

China's leader offers no new ideas

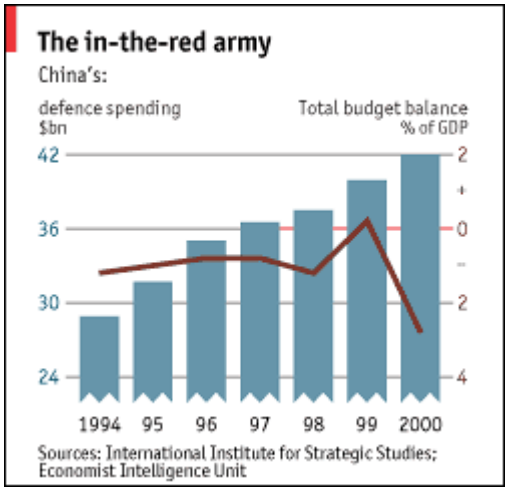
AP

Is Zhu's fire out?

IN HIS address to the National People's Congress, China's parliament, on March 5th, Zhu Rongji admitted that the country was facing “new difficulties and severe challenges”. But entering his last year as head of government, Mr Zhu offered no new solutions. He and his colleagues are too preoccupied with the leadership changes due to start later this year to spare time to tackle China's problems boldly.

When he took office in 1998, Mr Zhu pledged that “no matter what is waiting in front of me—whether it be landmines or an abyss—I will blaze my trail.” His trailblazing days appear to be over. Mr Zhu's two-hour speech at the opening of the congress in the Great Hall of the People in Beijing listed a host of perennial troubles, from corruption to growing unemployment and “deep-seated problems” in the economy. But he did not mention that many of these problems have worsened in the past four years. In his 1999 address, Mr Zhu sang the praises of grassroots democracy. and forswore the use of “dictatorial means against the people”. This time he gave democracy only a cursory mention.

Mr Zhu spoke of the new challenges posed by the country's entry into the World Trade Organisation in December, particularly to “less-competitive industries”. But he did not dwell on this issue. Securing China's admission to the WTO has been one of Mr Zhu's greatest—and most controversial—achievements. Within China many pessimists fear that domestic industries and agriculture will be crippled by the opening of its markets to foreign competitors, as required by WTO membership. The congress has always had a reputation as a rubber stamp for Communist Party policies, but it has started to become a little bolder in recent years. Some delegates will moan about the WTO, and by implication Mr Zhu, during the ten-day session.



The prime minister will also be obliquely criticised by some of the delegates for his efforts to boost economic growth through vast government spending, a policy he has pursued throughout his term. The minister of state planning, Zeng Peiyan, told the congress this week that China was aiming for 7% growth this year, only slightly less than last year's 7.3%, despite faltering export growth and weak domestic demand. Achieving this will involve pushing the budget deficit to a record $37 billion, a 19% bigger shortfall than last year's. The armed forces, as usual, are to be one of the main beneficiaries, with a 17.6% increase in their official budget. The actual amount they receive is reckoned by western analysts to be several times the published figure.

Some Chinese economists give warning that the country is piling up a dangerous amount of debt. Mr Zhu said his policy was “entirely correct” and the debt-to-GDP ratio was “still within safe limits”. But many analysts believe, as Song Guoqing of Beijing University argued in an article last December, that China should now be prepared to accept slower growth, and with it the danger of social unrest. Mr Zhu said in his speech, however, that maintaining social stability was of “vital importance”. The leadership does not want angry crowds on the streets this autumn when the party convenes its five-yearly congress, and when Mr Zhu, who is 73, is due to retire from the ruling Politburo along with many of his elderly colleagues. At next year's parliamentary session,

he is due to step down as prime minister. His successor—who is widely tipped to be the affable deputy prime minister, Wen Jiabao—will need a lot of courage if he is to rekindle the blaze.

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Hong Kong's budget

They were only teasing

Mar 7th 2002 | HONG KONG
From The Economist print edition

No tax reforms after all

AS ANTONY LEUNG, Hong Kong's new finance secretary, ended his budget speech on March 6th, there was both relief and surprise. For weeks, the government had been feeding the public's pessimism. Hong Kong's foreign-exchange reserves, its pundits had suggested, would run out by 2007. Others said a sales tax was needed. Mr Leung appeared to be preparing Hong Kong for something bold.

He was not, it turned out. Hong Kong is unusual in that it is, at once, in great shape and in dire straits. It is in great shape because it has no government debt: its funds are so large that investment income has been a major source of government revenue. It has a currency that is linked to the American dollar, and which shrugged off the unravelling of Argentina's superficially similar peg.

In part for the same reasons, Hong Kong is also theoretically in dire straits. Its taxes are low—indeed, none at all are levied on two-thirds of the workforce and 90% of companies—because the government has for two decades relied on land for revenue. As part of the handover arrangement between Britain and China, the government, which owns all the land in Hong Kong except that under the Anglican cathedral, created an artificial shortage until 1997. This resulted in a property bubble. Every time land was leased or redeveloped, at astronomical prices, the government got richer. It did not need to tax.

Those days are over. The land regime expired in 1997, when Asia slumped. Property prices have fallen by half since then, and government revenues from land have dried up. The government's investment income collapsed along with world stockmarkets.

Mr Leung was expected to deal with the issue by casting the tax net wider. But his budget ignored the tax base, tinkering only with duties on wine and other trifles. He suggested cutting the pay of Hong Kong's civil servants, which would reverse their generous increase of last year. There was not much else.

Was that reckless? Probably not. Independent economists have doubted all along the government forecasters' gloom. Hong Kong has deficits, but it also has things to privatise, should it need to. The economy is bad, but will get better. So it is odd that the government plays, year after year, this tax charade.

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Japan

Another scandal

Mar 7th 2002 | TOKYO
From The Economist print edition

More trouble at the foreign ministry

THE latest Japanese political scandal has already cost a foreign minister her job. It has lost Junichiro Koizumi, the prime minister, precious popularity points. It even threatened to hold up the passage of Japan's ¥81 trillion ($623 billion) budget for 2002, on which politicians have pinned their hopes for an economic recovery—though, in the end, the budget was comfortably passed by the lower house of parliament on March 6th. The scandal-ridden foreign ministry and Muneo Suzuki, a Diet member belonging to the ruling Liberal Democratic Party (LDP), are at the centre of the storm, both reeling from accusations of misconduct that may carry criminal implications.

It all started innocuously as a dispute over who was to blame for banning two non-governmental organisations from attending an Afghan aid conference held in Tokyo in January. Makiko Tanaka, the foreign minister at the time, accused Mr Suzuki, an excitable politician from Hokkaido, a northern island, who appears to have great sway with mandarins in the foreign ministry, of blocking the aid groups (supposedly because they had criticised the government) and tampering in ministry matters. Mr Suzuki denied the claim. Ms Tanaka's deputies failed to back her up. Mr Koizumi, anxious to restore calm and get the budget passed, sacked her for her part in the dispute—along with other sins—and opined that Mr Suzuki had not exercised undue influence in the affair. Unfortunately for Mr Koizumi, evidence given to parliament from the head of the groups in question on March 4th backed Ms Tanaka's version of events and not his.

But his role in the Afghan affair may now be the least of Mr Suzuki's problems. Fresh allegations of bid-rigging and meddling are coming thick and fast. Internal ministry documents appear to show that Mr Suzuki skewed bidding requirements for aid contracts in Kunashiri, one of four Russian-held islands claimed by Japan, to favour companies from his own constituency. There are also suspicions that Mr Suzuki may have interfered in an aid project to build a hydroelectric power station in Kenya.

Pressure from opposition parties forced Yoriko Kawaguchi, the new foreign minister, to conduct a rushed internal investigation into some of these accusations. The findings, released on March 4th, confirmed some of the claims, but fudged more. Though Ms Kawaguchi called the relationship between Mr Suzuki and her ministry “abnormal”, and added that it should never have been allowed, critics liken the foreign ministry's tepid investigation to “one robber investigating another robber”. Now that Mr Suzuki's pals in his party seem to have forsaken him and given in to opposition demands, he will have to respond to the allegations against him under oath in parliament on March 11th. Depending on what he says, the prosecutor's office could move in. He may also be asked to leave the LDP, or even step down as a member of the Diet. But he may manage to hang on: Mr Suzuki is a party loyalist, with strong ties to Hiromu Nonaka, a former king-maker in the LDP.

Whether Mr Koizumi, whose strategy so far has been to distance himself from all this, can tackle the rot will have important implications for his own future. His popularity, which has plunged since he sacked Ms Tanaka, could fall further if he fails to act. It will be a huge task. Voters want the foreign ministry, which is just as culpable as Mr Suzuki for the emerging scandals, cleaned up properly. Mr Koizumi has yet to keep his other promises of reform. He had better deliver this time.

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Vietnam

A killer still

Mar 7th 2002 | HANOI
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Worries over Agent Orange, a herbicide used in the Vietnam war

AMERICA'S ambassador, Raymond Burghardt, called Agent Orange “the last significant ghost” haunting relations between his country and Vietnam. He was speaking at a conference in Hanoi this week, sponsored by the governments of America and Vietnam, at which scientists and researchers discussed the lingering effects of the herbicide used by the United States during the Vietnam war. They presented findings that suggest that a carcinogenic component of Agent Orange has found its way into the food supply in some parts of Vietnam. But it seems that nothing has been done to limit its possible damage.

Between 1962 and 1971, American aircraft sprayed millions of gallons of Agent Orange over southern Vietnam, in an effort to clear the jungle foliage that helped to hide communist guerrillas. In the town of Bien Hoa, a former storage depot for Agent Orange and the site of a large spill in 1970, American researchers recently found that 95% of the people they tested had abnormally high levels of dioxin, which has links with cancer, birth defects and liver damage. Some had concentrations 200 times the usual level. Most worryingly, many of those with high concentrations were born long after 1971. Arnold Schecter, a researcher, reckons that at least six places in Vietnam, and possibly as many 100, are similarly heavily contaminated.

Such findings are explosive in the United States, since they raise the prospect of lawsuits and reparations claims—from Americans as well as Vietnamese. American ex-servicemen exposed to Agent Orange have mounted a successful case against Dow Chemical and Monsanto, the companies that made it. The American government has paid compensation to about 8,000 ex-servicemen who had health problems. Vietnam claims that 1m of its people suffer from ailments as a result of America's use of Agent Orange. As the conference began on March 3rd, American diplomats issued a pointed reminder that Vietnam had dropped all claims to compensation when the two countries resumed diplomatic relations in 1995.

The issue is a tricky one for Vietnam, too. It has not yet taken even basic measures to reduce possible damage to public health in areas exposed to herbicides. The residents of Bien Hoa, for example, still eat the fish that are the likeliest carriers of contamination. The Vietnamese government does not want to harm its promising tourist industry by creating a health scare. The conference ended with nothing more dramatic than a call for further study. But, like any self-respecting ghost, the problem will not just fade away.

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Israel and the Palestinians

The Middle East's bloodstained spiral

Mar 7th 2002 | JERUSALEM
From The Economist print edition

AP

Both Israelis and Palestinians try to make the cost in pain too high

Get article background

WAR it is, without mercy on either side. In the past week alone, more than 70 Palestinians and more than 30 Israelis, including many children, have been killed. The carnage mounts, day by day.

The important thing, Ariel Sharon told his ministers on March 3rd, was for them not to radiate gloom and doom. The night before, ten Israelis, including a whole family, had been killed by a suicide bomber in Jerusalem. That morning, another ten Israelis had died, seven of them soldiers, when a Palestinian sniper had opened fire at a road-block in the West Bank.

Next day, in a series of talks, Mr Sharon demonstrated the mood he wants his government to radiate. “We are in a hard war against a cruel and bloodthirsty enemy,” he said. “We must cause them losses, casualties...so that they understand they will gain nothing by terrorism. We must hit them, and hit them again and again, until they understand.” What about holding out the prospect of a political solution, the prime minister was asked? Now, he replied, was not the time for political prospects, only for military prospects.

As he spoke, warplanes, gunboats and tanks pounded targets across the West Bank and Gaza. The cabinet had ordered “incessant and relentless intensification of the military pressure”. Among the many victims was a mother and her three children, whom she was driving home from school in Ramallah. Two children in a passing car were also killed by the tank shell. The army apologised.

Late that night, a Palestinian assailant killed three Israelis at a restaurant in Tel Aviv. Next morning a suicide bomber killed one on a bus in the north of the country. A female settler was killed in an ambush near Bethlehem. That evening, near Ramallah, an Israeli helicopter rocketed a car carrying members of the al-Aqsa Brigades, the militants of Yasser Arafat's Fatah movement, who are responsible for a growing number of the attacks, both in the occupied territories and now in Israel too. Three men died. Overnight, armoured units smashed into villages and refugee camps in the Gaza strip, killing six people, three of them members of an activist's family. And so on and bloodily on.

The Americans are loth to intervene, despite urgings this week by President Hosni Mubarak of Egypt and others to send back their peace envoy, Anthony Zinni, who fled in frustration last December. There is some faint hope of more vigorous American involvement when the vice-president, Dick Cheney, tours the

region later this month. And, on March 6th, Colin Powell, the secretary of state, broke America's fairly solid support of Israeli policy by saying that “seeing how many Palestinians can be killed” is a strategy “that leads us nowhere”.

Israel's cabinet is split over Mr Arafat. Some of the ministers say openly that they want to see him dead, or driven into exile. Mr Sharon himself has proposed tightening the siege on the Palestinian leader by returning the Israeli tanks, pulled back a fortnight ago, to beneath his windows. Binyamin Ben-Eliezer, the defence minister and Labour leader, wants him set free. So Mr Arafat stays put, with missiles exploding even closer to his Ramallah office.

Mr Sharon, now sliding badly in the opinion polls, is right to concentrate his ministers' minds on morale. Incessant and relentless operations will soon require a larger mobilisation of reserves. Significantly, most of the soldiers killed at the road-block on March 3rd were reservists, some in their 30s and 40s. Their failure to fight back effectively against the lone gunman who, armed with only a non-automatic second-world-war carbine, shot at them for nearly half-an-hour before escaping, has seriously embarrassed the army.

It has also exacerbated the debates, raging on every street corner, over the point and purpose of their deaths. Were they defending their homes, as the right insists, or defending the homes of the settlers? The new rawness and intensity of the old political argument, coupled with Mr Sharon's own declining popularity, make the collapse of Israel's hybrid unity government more likely and more imminent.

The Israeli prime minister's departure is a clear Palestinian aim. Only the most foolish are under the illusion that they can defeat Israel militarily. All are aware that political negotiations are inevitable eventually. But few see any point to talks so long as Mr Sharon is in power. They hope to bring about a change by convincing the Israelis, in the words of Hussam Shahin, a young Fatah leader in Ramallah, that “while freedom costs, the occupation will cost them also.” They are buoyed by the fact that, after a year of asymmetrical losses, their uprising is starting to spread fear more evenly.

On the face of it, the Palestinians are in desperate straits. Never has the occupation been so entrenched or so lethal. The Israeli army has invaded two West Bank refugee camps and in effect reconquered large swathes of the Gaza strip. Children are traumatised, cities blockaded, roads closed, the economy devastated and the landscape blighted. But Palestinians roll with the blows.

Their mood, they say, is *sumud*, an Arabic term meaning a steely alloy of resilience and resistance. When the Israeli army entered Balata refugee camp near Nablus, the fighters slipped away, but the women stayed to guard their homes and tend the wounded. Old divisions have evaporated: Fatah and Hamas fight together, and all factions rally behind the besieged Mr Arafat. Nowadays most Palestinians support the suicide bombers as a just response to the killing of Palestinian civilians. “We have nothing left to lose,” shrugs a Fatah leader in a refugee camp.

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Iraq and the United Nations

Counter-offensive

Mar 7th 2002 | CAIRO
From The Economist print edition

Saddam Hussein reopens talks on weapons inspection

Get article background

IN A speech marking the Muslim Feast of the Sacrifice last month, Saddam Hussein taunted the United States. If America wants to overthrow his regime, he said, this was a policy he himself might back, since it was more “civilised” than attacking innocent Iraqis. The sarcasm was classic Saddam, but so too was the irony that his reluctance to sacrifice his own ambitions is a prime cause of his people's misery.

Mr Hussein and America's leaders have long locked horns over his failure to prove that Iraq no longer secretes nasty weapons. With George Bush's administration now taking active steps to get rid of him, Mr Hussein will be gored unless he beats a convincing retreat. His few remaining fair-weather friends are reluctantly lumbering towards the American side.

In recognition of the mounting pressure, Mr Hussein this week dispatched his foreign minister, Naji Hadithi, to relaunch stalled talks with the United Nations. The Iraqis say bravely that the talks are about getting sanctions lifted. The UN, for its part, insists that the agenda is about sending UN weapons inspectors back after a three-year hiatus. The fact that Mr Hadithi is accompanied by Iraqi weapons experts, and will, for the first time, sit face-to-face with Hans Blix, the head of the UN's idled disarmament mission, suggests that the UN's view is more accurate.

An editorial in a Baghdad daily run by Mr Hussein's son, Uday, has also hinted that Iraq is ready to show some unwonted flexibility. The article said that Iraq's chief objection to the arms inspectors is that there is no time limit on their snooping, raising Iraqi fears that they are merely a ploy to keep the country under sanctions indefinitely. The oblique suggestion is that Iraq would be more willing to negotiate if there were light at the end of the tunnel.

But Iraqi hopes of a kinder reception at the UN are likely to be misplaced. America still calls the shots, and everyone knows that this time the Americans are not bluffing. Even Russia, Iraq's main backer at the UN, has taken to distancing itself as part of an emerging strategic understanding with America. Russian objections torpedoed last year's American-British push to impose the “smart” sanctions, which would further squeeze Iraq while shifting the blame for its people's suffering. But Russia may well support the idea when the UN next renews its sanctions mandate in May.

If this does not alarm Mr Hussein, the new military signals should. Under cover of operations in Afghanistan, America has beefed up its forces in the Gulf. Aside from some 30,000 troops and huge stores of equipment, it has set up tactical commands for each of the four armed services in the region “with more than 1,000 war planners, logistics experts and support specialists”, according to a report from the Pentagon's Centre for Defence Information. The Americans have also established a disinformation unit directed at Iraq, amid talk of manufacturing a crisis if need be. One possibility, discussed in the Pentagon report, suggests that American special forces could retrieve “evidence” from Iraq of chemical-weapons development.

Iraq may not be able to count on the wobbliness of neighbouring regimes, either. The Bush administration's apparent haste to crush the Iraqi leader had frightened even its friendliest Middle Eastern governments. But, since then, the Americans have shown more understanding. When Vice-President Dick Cheney visits the region next week, he will both reassure the allies that America does not want to act with unilateral abandon—and emphasise American determination to see its will done. Significantly, the military chiefs of Turkey and Kuwait met in Ankara this week, along with representatives from the main Kurdish factions in northern Iraq.

The sole comfort to Mr Hussein may be that it will still take time for America to put all the pieces in place. By then, he may have decided it would be wise to invite the UN weapons people to tea in his bunker.

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Madagascar's two presidents

Vanilla revolution

Mar 7th 2002
From The Economist print edition

A lesson for Zimbabwe, perhaps?

RAFFIA hats, vanilla pods and textiles are Madagascar's better-known offerings to the world. But, claim supporters of Marc Ravalomanana, this island in the Indian Ocean may now be exporting an African model of a popular, mostly peaceful revolution against a rigged election.

Since December's presidential election showed no clear winner, a run-off vote was planned for this month. Mr Ravalomanana, the mayor of Antananarivo, officially won 46% of the vote, but his impatient supporters, claiming that their man would have won outright in an honest ballot, poured on to the streets of the capital in their hundreds of thousands. They hope, by their action, to prise Didier Ratsiraka, the ageing incumbent, from power.

For the moment Madagascar has two presidents and, this week, a delegation from the Organisation of African Unity is trying to sort matters out. Mr Ravalomanana, who has declared himself president and head of the armed forces, has picked a prime minister, Jacques Sylla, who says the old opposition will “take political power, but it will happen gradually”. On March 4th a clutch of newly-chosen ministers walked into the offices they claim to be theirs, despite a ring of soldiers who were blocking the ministry doors.

Mr Ratsiraka, who was prepared to wait for the run-off, has declared martial law and named a military governor for the city. But the protesters have ignored both military law and a night curfew. The centre of Antananarivo is now largely controlled by civilians manning barricades. “This is a soft revolution; it is a bit like a holiday every day,” says one resident.

Mr Ravalomanana has appointed a general as his minister of defence. He says that he believes that most of the army now supports him. He also claims that the country's civil servants, who have been on strike since January, will back his new government and return to work.

But Mr Ratsiraka is not yet finished. Five out of the six provincial governors still back him, and have set up a rival capital in Toamasina, the eastern port that is his home town. From there, they have been able to stop fuel supplies to the capital. Although Madagascar is not divided along ethnic lines, Mr Ratsiraka can draw backing from people living along the coast, and in lowland rural areas, who resent rule from the highland capital.

The first two months of the “revolution” were calm, but recently there have been violent clashes, and even some deaths. The army is likely to decide what happens next. After months of public protest in 1991, when Mr Ratsiraka was near the end of his 17 years of one-party socialist rule (he was re-elected, after a time out of government, in 1997), his soldiers fired into a crowd, killing about 100 people. This time, although senior generals on both sides have given warning of the risk of civil war, the army is clearly reluctant to open fire, or even to speak out.

The self-declared president is trying to win wider support by promising an early referendum on his rule. Mr Ravalomanana's actions are, at best, controversial. But Zimbabweans, awaiting their own dirty and possibly violent election at the weekend, are observing with interest how civilian pressure may bring a popular candidate to office against the odds.

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Yemen's discontented south

Nostalgia for a swashbuckler

Mar 7th 2002 | ADEN
From The Economist print edition

Secessionist stirrings in Aden prompted by ancient memories

Get article background

SOME letters written by Captain Stafford Bettesworth Haines, the conqueror of Aden when Queen Victoria was on the British throne, were published last month in *Al-Ayyam*, a Yemeni opposition newspaper. They are stirring secessionist thoughts. Almost 150 years after his death, the swashbuckling captain continues to hold sway over people's minds in this jagged tip of south Arabia.

Known as the “English sultan” for his 15-year rule of Aden, Haines repeatedly advised his superiors to elevate locals to fill senior administrative posts. Advice, notes *Al-Ayyam*, that Yemen's “unity” government would do well to heed. Two-thirds of the senior posts in Aden, grouches the newspaper, are in northern hands, including that of the chief of police, who is ensconced in the British ambassador's former residence.

The southern furore has not gone down well in Sanaa, the mountainous Yemeni capital, 345km (215 miles) to the north. A loyal newspaper, *26 September*, publicly denounced Hisham Bushraheel, the editor of *Al-Ayyam*, as a closet colonialist bent on returning the port to foreign rule. This is a loaded charge, particularly in the post-September 11th atmosphere, with America contemplating some return to Aden.

Moreover, retorts the north, the south's Marxist civil service was impossibly bloated. Officials in Sanaa say that before unification in 1990, 700,000 of South Yemen's 2m people held government posts, as opposed to 200,000 in the far more populous North. In the adjustment after unification, it was obvious that the south would bear the brunt of the cull.

But the complaints have struck a nerve. Eight years after its victory in the civil war that followed unification, Sanaa has yet to win the loyalty of its southern citizens. Adenis still pride themselves on their cosmopolitan way of life. Under the British, who ruled Aden for 128 years, it was the world's largest port after New York. Under Marxist rule from 1967 to 1990, it became the premier Soviet naval base in the Middle East. Today, half the world's container trade, and much of its oil, pass within 5km of Aden, but northern rule, and the country's fierce protection of its independence, have turned the port into a backwater.

Where liners once unloaded their passengers every half-hour, a new yacht now arrives perhaps once a week. America's earlier hopes to revive Aden as a useful refuelling port exploded when al-Qaeda, possibly backed by a member of President Ali Saleh's advisory council, bombed the *USS Cole* in October 2000.

Since their defeat in 1994, southerners have been complaining of creeping tribalism and religious militancy from the north. Under the Marxists, tribal institutions and religious schools were banned and a seventh-century self-declared prophet and rival of Muhammad was hailed as a revolutionary. But the northerners declared southerners kaffirs, or unbelievers, and ousted the socialists. Some southerners now claim that Mr Saleh, and his tribal backers, are not part of the solution in the war on terror, but part of the problem.

The south's protestations do not ring entirely true. After all, Mr Saleh, with limited means, has striven to heal the wounds of the civil war, and has cultivated the Adeni elite. Mr Bushraheel himself, note ruffled officials, was a guest of the North in his exile from the Marxists' authoritarian rule in the South.

Mr Saleh has declared Aden a duty-free zone, and since September 11th has spent almost as much time

in Aden as in Sanaa. He has allowed back some of the secessionist leaders from exile. Fully veiled women still recall with nostalgia the days when they frolicked in bikinis on the Gold Mohur sands. But the alcohol ban is much less rigorously enforced today than in the aftermath of the civil war, when Afghan Arab veterans swept down from the mountains to the coastal plains.

Captain Haines once hung the corpse of a would-be murderer in chains from Aden's Barrier Gate. But southerners prefer to recall his counsel that “goodness, kindness and respect will do more than the bayonet ever will.” If only, they bemoan, his warning were heeded today.

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Liberalising Europe

The need for shock treatment

Mar 7th 2002 | BRUSSELS
From The Economist print edition

The European Union summit in Barcelona will test the credibility of its economic-reform programme

WHAT could be more pleasant than Barcelona in spring, with a stroll down the Ramblas or tapas by the port? Sadly, what awaits the EU's leaders heading for their summit in Barcelona on March 15th and 16th is a lengthy discussion of electricity liberalisation in an airless conference room. And if that is not a gloomy enough prospect, there is more to cloud out any sunny optimism: the ten-year rolling programme of economic reforms that they unveiled with great fanfare in Lisbon two years ago is in deep trouble.

The “Lisbon process” was launched in large part because the EU's countries recognised they were falling behind the United States economically. In 1991 America's GDP per person was 42% greater than the EU average; by the end of 2001 the gap had widened to 54%. At Lisbon, Europeans were promised a programme of economic reforms that would make the EU the “most competitive and dynamic knowledge-based economy in the world” by 2010. Yet recently Frits Bolkestein, the EU's commissioner for the internal market, declared that “most of the key reforms announced at Lisbon are still on paper, waiting to be approved and implemented. The credibility of all community institutions is at stake.We can't keep on saying the cheque is in the mail.” Two years on, says the frustrated Mr Bolkestein, there is still “more poetry than motion”.

He highlights two reforms that were meant to have been wrapped up by the end of last year but which remain stuck. Efforts to create an EU-wide system of patent law, called a “community patent”, have foundered on arguments about which languages patents can be filed in. This issue is so sensitive and so bound up with national pride that the Barcelona summiteers will not even try to solve it. And plans to simplify EU rules on public procurement, which accounts for some 15% of the countries' aggregate GDP, have stalled. These were meant to have been approved last year. Efforts to create a pan-European code for corporate takeovers likewise came to grief last year, after 12 years, when they ran into opposition in Germany and in the European Parliament. The European Commission has appointed some “wise men” to try to find a way forward—to little effect so far.

But the outlook is not entirely bleak. A bundle of measures to liberalise telecoms markets was pushed through last year; limited liberalisation of Europe's postal services has been agreed on; and a financial-services “action plan” is making progress, raising hopes that European companies will soon have better access to more capital article. Meanwhile the commission remains pretty strict in upholding the existing laws of the EU's internal market. It started investigations this week of possible illegal state aid from Greece to Olympic Airways. A thumbs-down from the commission could bankrupt the Greek national carrier.

Yet even genuine advances for economic liberalisation threaten to be offset by a new wave of labour-market regulation which runs counter to Lisbon's professed desire to cut unemployment. The EU is working on a new directive to ensure that temporary workers hired through agencies receive the same pay and conditions as equivalent full-time workers.

If the Barcelona summit fails to give liberalisation a boost, then it is likely that the outside world will stop listening to the high-sounding promises made in Lisbon two years ago. For that reason, if no other, European leaders will want to come up with something they can point to as an achievement.

Get plugged in

Hence their concentration on electricity liberalisation. This issue has assumed a totemic significance because of France's stubborn refusal to free its markets and expose EDF, its state-owned national champion, to competition. Just ten days before the summit, France blocked a draft deal on electricity that was acceptable to all the other 14 EU countries. But a compromise may be possible in Barcelona, whereby France would agree to open up its market for business users of electricity, while allowing EDF to continue to overcharge householders. Hardly a victory for ordinary Europeans, but liberalisers desperate for any good news will doubtless talk up any such deal.

Meanwhile, events many miles from Barcelona may deepen the gloom at the summit. Europeans have long been urged to look to the United States for lessons in the benefits of liberalisation. America's decision to impose tariffs on steel imports, including those from Europe, will encourage Europe's powerful anti-globalisation movement to believe that the tide of the argument is now turning its way.

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France's presidential election

Level-pegging

Mar 7th 2002 | PARIS
From The Economist print edition

Lionel Jospin, the Socialist candidate, seems to be closing the gap

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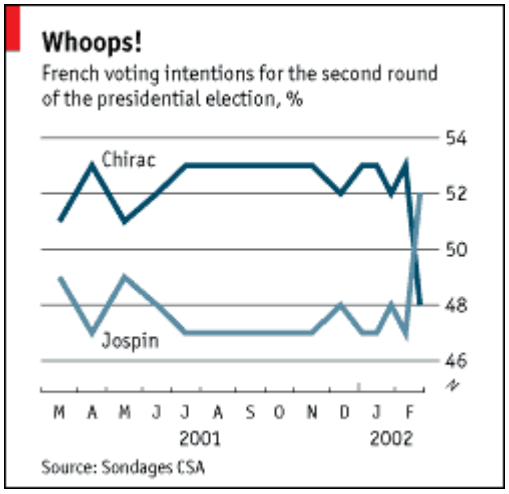

SHOULD Jacques Chirac be feeling nervous in his campaign to be re-elected president of France? Maybe, given the nasty news that his main rival, the Socialist prime minister, Lionel Jospin, has edged ahead in one opinion poll and is level-pegging, for the first time, in others. Moreover, a foray to seek votes in a crime-troubled suburb of Paris on March 4th went embarrassingly awry: while the conservative Mr Chirac, famous for his hand-shaking warmth, was denouncing the “culture of permissiveness” and “impunity”, he was denounced in turn as “Chirac, thief” by spitting and booing urchins.

Doubtless, matters could get worse, given the scandals that have swirled around the president over the past few months. For example, Didier Schuller, extradited from the Caribbean to face accusations of corruption involving Mr Chirac's political party, declared this week that he knew the president “well”, despite Mr Chirac's assertion that he could not remember having met him. Mr Jospin, bolstered by his reputation for Protestant integrity, primly says that no one—from the highest to the lowest—should benefit from “zero impunity”, a reference to Mr Chirac's invocation of presidential immunity.

But scandal-mongering is something Mr Chirac is adept at facing down. His bigger problem before the first round of the election on April 21st, and the expected run-off with Mr Jospin on May 5th, may be what his opponents call his “credibility”. Last week he promised voters that he would lower their income taxes by 5% this year and by 33% by 2007. The rejoinder from Mr Jospin's finance minister, Laurent Fabius, was that the French already had candidates from both left and right—and now they had one “from Father Christmas”.

One question, of course, is whether Mr Jospin's appeal is any more credible. His promises are marvellously woolly. France under his presidency will “definitively turn its back on unemployment”—and be “active”, “safe”, “fair”, “modern” and “strong”. Still, he concedes that under his prime ministership crime has risen even as unemployment has dropped. He disarmingly admits to having been “a little naive” in the past.

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Germany's election

Doubts in Bavaria

Mar 7th 2002 | BERLIN
From The Economist print edition

Germans are beginning to question Edmund Stoiber's economic credentials

Reuters

Too much froth, too little consistency?

TWO months after Edmund Stoiber's triumphant adoption as the right's champion in Germany's general election in September, and a decidedly bouncy start, is he beginning to falter? As leader of one of Germany's richest states, Bavaria, he soon began scoring easy points with his attacks on the government's poor economic record. But people have now begun to ask whether Mr Stoiber has the imaginative ideas needed to haul Germany out of its doldrums.

Even his much-lauded economic performance in his home state has begun to lose a bit of its shine, as figures show that Bavaria's economy grew by only 0.9% last year, hardly better than the 0.6% for the country as a whole. That puts Mr Stoiber's state, which once had Germany's fastest-growing economy, down to sixth place among the 16 *Länder* (states). If the debt-ridden Bavarian-based Kirch media empire were to collapse, as it may, that would tarnish Mr Stoiber's credentials still more, since its main creditor is the state-controlled Bayerische Landesbank.

Moreover, some of Mr Stoiber's policies seem unclear or contradictory. People are beginning to wonder what he really stands for. At first he promised to abolish the unpopular “green” tax on energy; then he said he would merely stand in the way of any further increases. He pledged to rescind a new law to phase out nuclear energy; then he said it should perhaps only be revised. Whereas other leaders on the right say that tax cuts planned for 2003 and 2005 should be brought forward to boost the economy, he says that budgetary restraints would make that impossible. After opposing the Social Democratic government's tax reforms because they did not go far enough, he now complains that the cuts already made have deprived the *Länder* of a major source of revenue.

On go the contradictions. He calls for a loosening of Germany's notoriously sticky labour market, yet says that public contracts should be awarded only to firms that apply collectively-agreed wage rates. He urges cuts in welfare contributions, but has yet to show where the corresponding savings would be made. He advocates leaner, less interfering government, yet does not hesitate in his own state to dole out fat public subsidies wherever he sees fit. He claims that he does not want immigration to be an election issue, yet is doing his utmost to block new laws on immigration deemed essential by employers to let skilled foreign workers into the country.

Nor did a recent round of local elections in Bavaria give Mr Stoiber's Christian Social Union, the sister party of the Christian Democrats who carry the right's banner elsewhere in Germany, an expected boost. Despite a flagging economy and rising unemployment, Chancellor Gerhard Schröder's Social Democrats held their ground, even chalking up some big victories, notably in Munich, Bavaria's capital, where an incumbent Social Democratic mayor was re-elected in the first round with an even bigger vote than before, and in Nuremberg, Bavaria's second city, where the Social Democrats now look poised to take the city hall from Mr Stoiber's party in a run-off.

Mr Stoiber is slipping in the opinion polls too. A month ago, they suggested that in a direct vote for chancellor (which the electorate does not have, because parliament chooses him after the general election) he would be only three percentage points behind Mr Schröder. Now the pollsters put the Bavarian contender six points adrift. And in the popularity stakes he has dropped to fifth place, behind even Angela Merkel, the Christian Democrats' leader whom Mr Stoiber defeated to be the right's candidate for chancellor. Though more Germans say they will vote for his and Mrs Merkel's parties than

for the Social Democrats, their combined figure is dipping a bit too.

So, with signs that the economy may start improving by mid-summer, the Social Democrats are beginning to take new heart. They hope that Mr Schröder, who comes across as warmer than the stiff Bavarian technocrat, will edge further ahead once campaigning gets seriously under way. Mr Stoiber must produce some ideas for mending the economy that are neither too costly nor too painful.

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Russia, NATO and the Balts

Putin's unscrambled eggs

Mar 7th 2002 | TALLINN
From The Economist print edition

Russia, NATO and even the Baltic states may end up friends

Get article background

EPA

KGB man with snow on his boots

YOU cannot make an omelette, Stalin infamously remarked, without breaking eggs. Can Russia's president, Vladimir Putin, unscramble the dismal results of Soviet cooking?

His recent efforts have been stunning. He has just nonchalantly accepted an expanded (albeit tiny) American military presence in Georgia, a former Soviet republic from which Russia's troops are grudgingly withdrawing. The American soldiers will train and equip the Georgians to fight Islamic extremists believed to be sheltering in the remote and lawless Pankisi valley that borders on Russia's own breakaway republic of Chechnya.

Russia is also thinking again about old allies that the Americans detest. Its relations with Iraq have cooled sharply. Some well-informed Americans even think that Russia may be willing to help America topple Saddam Hussein, perhaps in return for juicy oil and building contracts afterwards. There are signs too of Russia back-pedalling a bit over its controversial nuclear-power contracts with Iran. Meanwhile, its ties with Western Europe have never been better.

Russia is also talking hard to NATO about “an alliance with the alliance”, in the words of Mikhail Margelov, head of the foreign-affairs committee in parliament's upper house. An early practical sign of this may be seen in Kirgizstan, a former Soviet republic neighbouring China, where America and other NATO countries have set up a large military base. The official reason is to help with the war in Afghanistan. The real one, Russian policymakers like to claim privately, is a signal to China of joint western and Russian interest in the region.

Whether NATO turns into a European peacekeeping organisation or takes on a more global role, Russia would certainly have something to offer as an ally, both by virtue of its geography and with some of its military assets—heavy-lift aircraft, for example. But there are still plenty of snags.

One is Russia itself, where many officials are deeply unenthusiastic about the sorts of co-operative policies they would have to implement to work alongside the alliance. Others are legacies of Russia's empire, in the form of client states and statelets still wedded to the bad habits of the past. Belarus, for example, on paper Russia's closest ally, stands accused by the United States of training Iraqi air-defence forces and selling weapons, including Russian-made ones, to all and sundry. Belarus denies this but the Kremlin's silence on the matter has been telling.

Probably the biggest and most ticklish issue is the enlargement of NATO. At its summit in Prague in November, the alliance may well decide to invite the three Baltic states of Estonia, Latvia and Lithuania to join. That would have seemed impossibly provocative only five years ago. Increasing readiness to think about membership for them now owes something to the three little countries' lobbying and to an improvement in their modest military efforts, but rather more to other changes.

Why Balts are bullish

First, Russian bluster in the past proved counter-productive. The more the Kremlin huffed and puffed that the alliance should stay away from ex-Soviet countries, the more it underlined their need for security.

Second, Mr Putin has heavily toned down the Kremlin's objections, now saying only that enlargement is pointless. This reflects his dislike of losing battles, Russia's own much friendlier relations with the alliance, and a growing sense that the real security threat to Russia is from the south and east, not the west.

Third, say Russian and other cynics, NATO in fact no longer matters that much militarily anyway. Some Americans at least now see it more as a political outfit than as Europe's nuclear guarantor. It has a role in training and in harmonising equipment but when it comes to waging a real war in future, the argument runs, the Americans, as in Afghanistan (and as in the Gulf war 11 years ago), will make their own plans and pick their own allies. The Russians find that thought reassuring: they much prefer dealing directly with the Americans than with a NATO that includes pipsqueak former satellites.

For all these reasons, if Russia stays friendly, it would have less reason to mind if the Balts were invited to join NATO. And if that were to happen, Finnish officials reckon their country might not be far behind, followed, after a suitable period of dithering, by Sweden. None of this is decided. Nor is it certain that Russia's more relaxed attitude to a larger NATO and much else will endure. Mr Putin seems strikingly isolated at home. When America's military venture in Georgia was first announced, many prominent Russians were critical. There are fears that if his more western-friendly policy does not pay dividends of some sort soon, Mr Putin may feel obliged to backtrack.

Such worries may, however, be overblown. The grumblers have no alternative to put forward to Mr Putin's approach: that if Russia wants economic prosperity and respect, the only choice for the moment is to join the outside world, not sulk in a corner. And Russians have little choice but to do Mr Putin's bidding.

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The euro

Two sides to every coin

Mar 7th 2002
From The Economist print edition

Three of Europe's midget countries are minting their own, rare, euro coins

ONE side of every euro coin has a national design. Belgian ones show King Albert's head, Irish ones a Celtic harp. The European Central Bank (ECB) has long made it plain that any coin minted in one euro-zone country is good for buying or selling anything in all of them. But many European cashiers may be surprised when they are asked to take euros displaying the face of Monaco's Prince Rainier.

Three of Europe's tiniest states—Monaco, San Marino and the Vatican—have been granted permission to mint their own euro coins with distinctive national motifs. In a sea of 50 billion new coins, the numbers of euros produced by the midgets are tiny: all the Vatican's coins, which show Pope John Paul's profile, are worth a mere *euro*670,000 in the bank. Their rarity, though, increases their value: already, traders on eBay, an auction website, have taken bids of up to *euro*316 for a set of the eight coins that are supposed to be worth only *euro*3.88. A “starter kit” of Monaco's coins worth *euro*15.25 in a bank is going for *euro*275.

None of the three countries is even in the EU, but all are so integrated into the Union's business that adopting the euro was only practical. Andorra, Montenegro and Kosovo have also taken up the new currency, but without minting their own coins. Though pleased at the new currency's acceptance outside the euro-zone, the ECB makes no mention of the tiny states' coins on its web pages. Perhaps it is embarrassed that the three midgets have produced the only euros whose value has been going up.

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Switzerland and the UN

Just a toe across the line

Mar 7th 2002 | GENEVA
From The Economist print edition

Joining the UN doesn't mean the Swiss will join the EU too

Reuters

Blocher lost

IF THE posters of the anti-UN campaign were to be believed, on March 3rd the people of Switzerland wantonly drove an axe through centuries of their country's prized neutrality by voting in a referendum to join the United Nations. It is not quite like that. True, 55% of the voters were ready to open this particular door to the outside world, in a 58% turnout, a sharp contrast with the three-quarters who voted against UN membership only 15 years ago. The highest Yes vote, 67%, was in French-speaking Geneva, a fervently pro-UN canton where, despite the country's non-membership, a lot of UN agencies have set up their offices.

But by a second test of votes in Switzerland's direct-democracy system—the proposal also had to win in a majority of the country's cantons—the UN's backers achieved only the narrowest of victories, 12 cantons to 11. Swizerland was fairly neatly split between its rural and largely mountainous east and the more urban west. The government is now trying to soothe the fears of the German-speaking losers in the country's eastern heartland, such as the tiny half-canton of Appenzell Inner-Rhoden, where 68% of the voters (by head-count, a total of 4,486 people) said No. Switzerland's neutrality will not change, it repeated. Ministers swiftly dismissed queries about the next step the government, but so far not many voters, would like: joining the European Union.

The Yes campaign was backed by most Swiss businessmen, worried that, although Swiss companies make most of their money abroad, the country is regarded by many foreigners as snootily aloof. In fact, Switzerland has long been relatively relaxed about the UN. Since the 1950s it has been an active member of many UN agencies, some of them based in Geneva. Over the past decade it has voluntarily implemented all UN decisions on sanctions. And in a referendum last year the Swiss had already approved plans to allow armed Swiss troops to take part in UN peacekeeping missions when their politicians think it is safe to do so.

The division was not the familiar split between French- and German-speaking Switzerland. The French side gave a pretty straight Yes. But in the mainly German-speaking regions, Zurich—the most populous canton, the country's business capital and home to most of the banking and insurance industry—went for Yes too. So did Bern, the country's capital, both the Basle cantons, Solothurn, rich little Zug and, a bit surprisingly, Luzern, which gets a lot of foreign tourists and whose people are not hostile to the outside world provided they feel they can go on living the way they like. A mild disappointment for the Yes camp was the No in Italian-speaking Ticino.

Anyway, joining the UN involves no loss of sovereignty for the Swiss. If Switzerland were to join the EU, on the other hand, those Luzerners—and all other Swiss—would have to give up some of the decision-making powers their country's direct-democracy system gives them. After several referendum setbacks, the Swiss government has put off its ambitions for EU membership until later in the decade. And most Swiss businessmen seem happy with the bilateral economic and social accords now being implemented or negotiated with the EU.

There could, though, be another result of Sunday's vote. Those who do not want Switzerland to plunge deeper into the world are still a big minority: 45% said No even to dipping their toes into the UN. They were following the advice of the right-wing Swiss People's Party, which won 51 out of 246 seats in parliament three years ago, an achievement that made it the third-largest party. Its lonely anti-UN

campaign was led by a billionaire businessman-cum-politician, Christoph Blocher, who is going to stay in the fight. Since the referendum votes were counted, the other parties have been cocking an anxious eye towards next year's general election.

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Charlemagne

Paddy Ashdown, latest Balkan proconsul

Mar 7th 2002
From The Economist print edition

Must outsiders run the Balkans indefinitely?

ASTONISHING though this may sound, the Balkans have recently been doing remarkably well. Three years ago, 860,000-odd Kosovars had to flee their province. Bosnia was still a bloodstained wreck, barely starting to recover from its terrible war. Yugoslavia was run by a vicious dictator, Slobodan Milosevic, Croatia by the not-much-nicer Franjo Tudjman. The Balkans were a byword for mayhem, despotism and disaster.

Today's picture is very different. Those two tyrants, who dominated the biggest bits of the old Yugoslavia, have gone, one to the UN's war-crimes dock in The Hague, the other to his grave. Croatia and Serbia are both now run by genuine reformers. Bosnia is at peace and, though its chief villain, Radovan Karadzic, once again escaped the clutches of NATO troops last week, his days as a free man may at last be numbered. In the past two years, Bosnia has benefited from a swathe of reforms. Most encouragingly of all, the number of Bosnian refugees returning to areas in which they are an ethnic minority has been swelling. More than 200,000 such people have come back in the past three years, 90,000 last year alone.

Nor is Kosovo without hope. Its Albanians are back home and unyoked from their Serb masters; Kosovo's parliament has just elected as the province's president Ibrahim Rugova, the most decent Kosovar on offer. Serbia's prime minister does not even rule out the possibility that the province may secede peacefully from Yugoslavia, of which it is still formally a part. Montenegro, the only statelet left within the rump of federal Yugoslavia, may peacefully become independent this summer. Though that could be a mixed blessing, Yugoslavia's final dismembering should make it easier for a Serb government in Belgrade to consider the vexed question of Kosovo's “final status”. Even Macedonia, the most worrying Balkan trouble-spot today, has not descended into wholesale civil war, as it has threatened to do since last summer, despite a bout of bloodshed last week.

The three territories that still need the most careful nurturing—Bosnia, Kosovo and Macedonia—also happen to be under the tutelage of an unusually impressive bunch of foreign overseers. Michael Steiner, a savvy German, runs Kosovo for the UN. Wearing an EU hat, Alain Le Roy, a Frenchman, has made a good start as a cajoler-towards-peace (with less clout than his colleagues) in Macedonia. Wolfgang Petritsch, an Austrian with useful Slovene roots, has done well as “high representative” in Bosnia. And Paddy Ashdown—a peer who once led Britain's Liberal Democrats and who, it was formally announced last week, takes over from Mr Petritsch in May—has good credentials for pushing Bosnia further in the right direction. It will be a “dream team”, says one of NATO's leading Balkan-watchers.

In the early 1990s, while European governments dithered, Lord Ashdown was calling for a stronger military intervention in Bosnia. His career as a Royal Marine commando, diplomat and helicopter salesman before he became a politician should serve him well. He has been an avid follower of the Balkan imbroglio for a good decade (and has even been learning Serbo-Croat). He has a hopeful but hard-nosed view of the way ahead.

Comparatively rosy as the latest picture may be, numerous blots still spoil the canvas. Ethnic-Albanian rebel factions in Macedonia, bolstered by cash from heroin trafficking, may be thirsting for a fight. So may some Slav Macedonians in the government. Kosovo remains a nest of criminality, with many vengeful Kosovars itching to expel (or kill) the few Serbs who remain. And Bosnia is still far from being a normal country, divided as it is into ethnic “entities”: a Serb Republic, where murderous Mr Karadzic still finds shelter, and a Muslim-Croat federation whose two peoples are often at loggerheads.

So Lord Ashdown faces huge challenges. The most pressing, as for Mr Steiner in Kosovo, is to create

something of a rule of law, with a better police and judiciary. A more complex task is to lay the groundwork for a much simpler constitution. At present Bosnia's various levels of government have some 13 prime ministers. Nor can the country continue indefinitely to have three separate tribal armies.

Protectorates for ever?

Outsiders such as Lord Ashdown, well-qualified as he is, cannot hope to invent very fast a multi-ethnic democracy that never existed, even though he and Mr Petritsch both reckon that, perhaps within a decade, Bosnia should be able to stand on it own feet without foreign military guarantors. For the time being, Bosnia and Kosovo still rely for security on some 55,000 NATO-led soldiers. The number in Bosnia has dropped from nearly 60,000 when the war ended to around 17,000 today—and may fall to as few as 12,000 by the time Lord Ashdown starts his job. But they remain vital all the same.

Lord Ashdown is particularly keen, as is Mr Petritsch, that Europe should become the main actor on the Balkan stage, though it was undoubtedly American military muscle that paved the way to peace. American troops in Bosnia have dropped from a third to a sixth of the peacekeeping force. In Kosovo they are proportionally fewer. In Macedonia the Americans have no fighting troops on the ground at all. Lord Ashdown and Mr Petritsch put much stock on a recent agreement that, come the autumn, the EU will take over the police in Bosnia, who previously wore UN hats. Unlike Mr Petritsch, Lord Ashdown will formally represent the EU in Bosnia as well as answer to a Peace Implementation Council where all involved countries have a voice.

“In together, out together” is still America's mantra, despite its growing entanglements elsewhere in the world. And the United States is still a crucial if less visible partner for Europe in the Balkans. Lord Ashdown knows it must stay. But he is an ardent European. Expect another mantra, “the Europeanisation of the Balkans”, to be heard more regularly under his proconsulship.

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About sponsorship

Privacy

Whose life is it anyway?

Mar 7th 2002
From The Economist print edition

Report Digital

Britain's courts are, in effect, legislating to protect privacy and restrain the tabloids. It sounds good, but it's dangerous

“I'M WITH you on a free press, it's the newspapers I can't stand,” says a character in Tom Stoppard's play, *Night and Day*. Britain's judges appear to agree: they seem bent on curbing the freedom of the press to protect individuals' privacy.

For a nation of secretive people, Britain is curiously casual about privacy. Its newspapers intrude on the lives of their subjects, celebrated or obscure, more than those in any other country. That is partly because the newspaper business, with ten national daily titles fighting for a shrinking market, is viciously competitive. But it is also because governments have been unwilling to take on the press and legislate, in the way that most other rich countries have, to protect the privacy of individuals.

In Britain, the press is left to regulate itself through the Press Complaints Commission. The PCC's reputation is currently at a low ebb. It recently lost its chairman, Lord Wakeham, who stepped down because he is a director of Enron. Lord Wakeham is regarded as an excellent fixer whose skill at managing his relationship with powerful people is not matched by a determination to protect the targets of the tabloids. Charles Moore, editor of the *Daily Telegraph*, says he dislikes “the cosy relationship between the PCC's chairman, its director and the tabloids.”

Two recent decisions have been widely criticised. The PCC upheld a complaint from Tony Blair about a diary item in the *Daily Telegraph* which revealed that his 17-year-old son Euan had been interviewed for a place at Trinity College, Oxford. As the university's admissions policy had recently been attacked by the chancellor for being “an old boy network” and the head of the college, Lord Beloff, was a close friend of the Blairs, the paper understandably defended the piece on public-interest grounds. The PCC disagreed, saying the article was an unnecessary intrusion.

The PCC took a different line when the *Sunday People* published a set of nude pictures of Sara Cox, a radio presenter, and her husband on their honeymoon. The paper's editor, Neil Wallis, a member of the PCC's code committee, apologised. That was sufficient for the commission but not for Ms Cox. She is now suing for damages which are likely to be sizeable. The *Daily Star*, which published snatched semi-nude pictures of Amanda Holden, an actress, paid £40,000 damages and £75,000 in costs in an out-of-court settlement last year.

A decade ago, intrusion into the lives of minor celebrities was not something that courts felt they could

remedy. In 1987, Gordon Kaye, an actor, was photographed lying in hospital with serious head injuries. His claim against the *Sunday Sport* was dismissed in 1990. The court ruled that “there is no right to privacy.”

But now the judges are brandishing the Human Rights Act (HRA), which incorporates the European Convention on Human Rights, and guarantees a right to privacy. Six years ago, Lord Bingham, then Lord Chief Justice, warned that if the government failed to legislate on privacy, “the courts will not be found wanting.” During the passage of the HRA , the Lord Chancellor, Lord Irvine, said that the judges were “pen-poised” to develop a privacy law.

A series of cases before the courts shows that the judges were serious. Catherine Zeta-Jones and Michael Douglas, for instance, have brought a case against *Hello!*. They had granted its rival, *OK!*, exclusive rights to the photographs of their wedding. That did not stop *Hello!* from getting its own pictures and publishing them. In a preliminary ruling, the Court of Appeal declined to grant an injunction but said that there was an arguable right to privacy even though the actors had approved use of the wedding photographs elsewhere.

Another case still before the courts was brought by Naomi Campbell, a model, against the *Mirror*, which published a photograph of her leaving a meeting of Narcotics Anonymous. Judgment on the action, brought on grounds of privacy and breach of confidence, has been reserved; but informed sources predict that Ms Campbell is likely to win.

Lord Justice Sedley, one of the three judges in the Douglas and Zeta-Jones case, went so far as to say: “The law recognises and will appropriately protect a right of personal privacy.” If celebrity claimants are to have commercial agreements protected by a right to privacy, then there will be a flood of speculative litigation.

The main consequence of judicial activism will be to threaten the livelihoods of tabloid newspapers and the paparazzi who feed them. Nobody is likely to cry about that, since the tabloids are generally despised even by those who read them. But there is something more serious at stake. Law put together piecemeal by the courts will be messy, and it risks protecting secrecy that should be exposed as well as privacy that shouldn't.

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Criminal justice

Guilty as charged

Mar 7th 2002
From The Economist print edition

Britain's top policeman describes the criminal-justice system as “appalling”

RELATIONS between the police and the government are deteriorating even faster than street crime is rising. Not much is heard these days of Tony Blair's favourite slogan in opposition that New Labour would be tough on crime and tough on the causes of crime. Instead, there are recriminations about why the police are failing to clear up three-quarters of all offences.

Fewer than one in ten crimes now result in a conviction. In London the position is particularly bad. Muggings and robbery having risen by 40% in the past nine months. In Lambeth, the clear-up rate for robbery fell last year from 7% to 5% and for burglary from 8% to 6%.

The home secretary, David Blunkett, who is intent on fundamental police reform, issued a blunt warning last month that he would intervene in the policing of London if street crime and robbery were not brought rapidly under control.

The warning went down badly with the hard-pressed, under-staffed Metropolitan Police. On March 6th its commissioner, Sir John Stevens, hit back, blaming the politicians for their failure to reform criminal law. He described Britain's criminal-justice system as “appalling” and said that, over the past 20 years, numerous official reports highlighting the loopholes in the way it worked had been pigeon-holed.

Sir John, whose temper is said to be even shorter than the home secretary's, warned that if the latest reform proposals, put forward by Lord Justice Auld in a report published last year, suffered the same fate as their predecessors then “we allow a situation where—as others have forecast—anarchy cannot be far away.”

The commissioner has a point. In London, muggers are quite often released on bail eight or nine times before they face trial for their first attack. When they do get to court, the lack of separate facilities for defence and prosecution witnesses frequently leads to intimidation. One survey found that 83% of witnesses who had appeared in court never wanted anything more to do with the criminal-justice system. More than 40% of witnesses said they felt intimidated by the defendant or his lawyer.

The commissioner's claim that the trial process is now so heavily weighted in favour of the defendant that “the guilty are walking out almost as if through a revolving door” appears less soundly based. The burden of disclosure on the prosecution can, admittedly, be onerous and this is not matched by similar obligations on the defence. But many more prosecutions fail through sloppy preparation than through defence ambushes or legal technicalities, and others still fail because, after so many high-profile cases of police abuse and miscarriage of justice, juries simply do not trust the police these days.

That police numbers are falling at a time when street crime is sharply rising is the politicians' fault, but the police also need to look at their own record. Since 1989, the clear-up rate for all crimes has dropped by more than a third. For two decades rank-and-file police have successfully resisted reform of their archaic working practices. The commissioner is right that the court system needs reforming, but so do the police.

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Boating

Holed

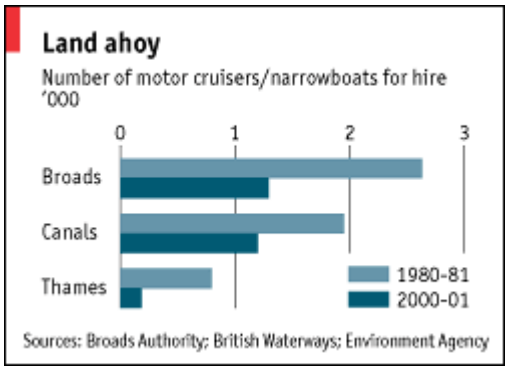
Mar 7th 2002
From The Economist print edition

The boating business is sinking fast

“THERE is nothing—absolutely nothing—half so much worth doing as simply messing about in boats.” So enthuses Rat in “The Wind in the Willows”, a much-loved British children's book published in 1908. Britain's holiday-makers, many of whom once agreed, now seem to have their doubts. The boat-hire industry, which mainly rents out small motor craft on inland waterways, has been shrinking for some time. But recent figures suggest that in places it has nearly disappeared.

On the Norfolk Broads, an area renowned for inland sailing, the number of boats has halved over the past couple of decades. Things are slightly better on the canal network, which continues to benefit from a restoration programme; but capacity has still shrunk by over a third in the last 20 years. On the Thames, high land values encourage owners to redevelop marinas for housing; there, the number of hire boats has fallen from around 800 two decades ago to 186 today.

Part of this trend can be put down to the decline in domestic tourism, which has seen the number of holidays taken by Britons in Britain fall by 12% over the last decade. But the fall in boat trips has been steeper. While flights got cheaper, demand for better facilities pushed up the cost of boats. And, as surplus capacity rose and profits fell, many owners could no longer afford to upgrade their fleets.



Meanwhile, the industry proved too fragmented to come up with a coherent response. Most firms are family-run; few have the resources to invest in training or marketing. Sally Ash of British Waterways, which controls the canal network, says that trying to get them to co-operate is “like getting blood out of a stone”. Robyn Griffith-Jones, who works for the Environment Agency's new Thames Ahead initiative, makes a similar point about leisure provision. There are 25 local authorities along the non-tidal Thames; the river, which is usually the administrative boundary, can be peripheral in more ways than one.

Hiring out boats is a risky business at the best of times. The season lasts for only half the year; even then, Britain is hardly awash with jolly boating weather. Nor is operating locks and mopping decks everyone's idea of fun. Small wonder, then, that some owners have thrown in the towel—and that a few noisy not-in-my-back-yarders are delighted to see them go.

But townies with a captain complex are not alone in regretting the loss. The main waterways agencies have belatedly recognised the business's value in keeping the riverbanks alive. A trade association, Waterway Holidays UK, was set up 18 months ago to market boating both at home and abroad. This may not be enough to stop a very British tradition from disappearing beneath the waves.

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Public-sector pay

London's bad deal

Mar 7th 2002
From The Economist print edition

The capital's public services are suffering because workers are underpaid

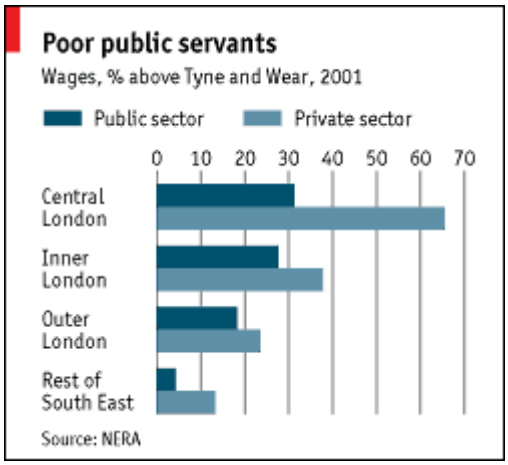
LONDON'S teachers are planning a one-day strike on March 14th. They maintain that their pay does not adequately compensate them for the high cost of living and working in London. Figures just published by NERA, an economics consultancy, suggest that they are right, and that their point applies to all sorts of other public-sector workers as well.

The government determines how much money to give councils partly according to the needs of the local population, and partly according to the cost of providing services. This formula takes into account the need to pay public-sector workers more in London. But NERA's figures suggest that the government should be paying a larger premium to workers in and around London than it does.

The government uses existing regional pay differentials to calculate the rate at which it should compensate councils in the south-east for higher wages. This, to the authors of the NERA report, is absurdly circular. It should instead be looking at regional differentials in the private sector, which reflect the extra cost of hiring people with the same qualifications and experience in and around London.

On average, the government reckons that relevant wages in outer London are 15% higher than in the rest of England while the comparable NERA estimate would probably exceed 20%. For inner London (excluding the City), the government figure is 30%; a comparable NERA figure would probably be around 40%.

For teachers, the disparity is even sharper. Teachers in inner London will be getting an allowance of £3,105 a year, worth about 18% to a newly-qualified teacher and 12% at the top of the basic pay scale, to cover the extra costs of living in the capital. They are threatening to strike if the allowance is not increased to £4,000. Applying NERA figures suggests the allowance should be more than £9,000.



The results of underpaying public-sector workers are predictable. Teacher vacancy rates in London are more than two-and-a-half times the national average. According to the National Union of Teachers, London's schools are held together only with antipodean short-termers, earning money to go backpacking in Europe.

It's a similar story with the police. Despite generous allowances, London's police have had difficulty filling their training intake. Last year, the government increased the allowances by 11-16% of a constable's pay and the police training college is full. But even with London benefits, which can be worth around 40% of a new constable's pay, the police trade union says the flow of roughly 40 London officers a month to other forces is several times the inflow.

Underpaying public servants will lead to deteriorating public services. Since London's high-wage economy generates a disproportionate share of tax revenues, Londoners are likely to get grumpier than they already are.

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Science and sexism

Let him who is without sin

Mar 7th 2002
From The Economist print edition

Politicians are nosing around the affairs of elite scientific societies

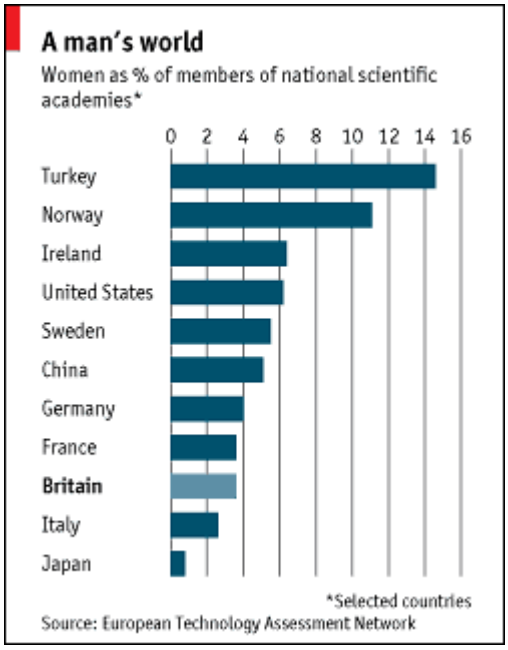
A HOUSE OF COMMONS committee is to look at how the government manages to spend at least £29m a year (embarrassingly, nobody knows exactly how much) on some of Britain's scientific societies. MPs will be asking difficult questions about who gets into these elite British clubs, and how they get there. And one issue is that the most generously funded of these, Britain's prestigious Royal Society (RS), has had hardly any women in it since it was founded in 1660.

Ian Gibson, chairman of the Commons committee on science and technology, wants to find out whether membership of these societies is truly democratic. It is, he says, a can of worms but he wants to know if the "rumours" about how people get into such societies are true. Any scientist (such as Mr Gibson once was) knows the gossip that fellowship is as much about who you know as what you know.

Julia Higgins, professor of polymer science at Imperial College in London and the RS's foreign secretary, agrees there are too few women fellows. But she says their number reflects the gender balance in the upper echelons of science, where fellows are chosen from. The RS argues that it is an elite society and members are chosen for excellence. Furthermore, although these days more women take science degrees, few of them stay in science and get to the top. Wastage is high.

As of March 2002, the proportion of female RS fellows was around 3.7%. Not very good, on either an absolute or a comparative basis (see chart). But fellows are elected for life, and membership hovers around 1,300, so changes in society are reflected only slowly in RS membership. The eldest fellow of the RS—Professor Wilson Baker—was elected in 1946. He is 102 years old. Among fellows below the age of 65, 4.5% are women.

Unlike RS fellows, MPs cannot argue that slow turnover among their number masks change. They were all elected last year. Which raises the question of whether a ten-man (and one-woman) committee of MPs is qualified to investigate sexism among scientists.



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Cumbria

The disaster that never was

Mar 7th 2002 | KESWICK, CUMBRIA
From The Economist print edition

AP

Since Cumbria was the centre of the foot-and-mouth epidemic, predictions of economic collapse were rife. Actually, the place is doing fine

Get article background

HIGH on a hill above Derwent Water, farmer Will Cockbain has a fabulous view of the Lake District's peaks. A year ago, the scene was oddly empty. As foot-and-mouth disease (FMD) raged, sheep were being taken from the hills for slaughter and the valleys were empty of tourists. Of Britain's 2,030 FMD cases, 893 were in Cumbria. Economic disaster loomed.

A year on, and Mr Cockbain says: “I never thought I'd hear myself say it, but we have come through it better than most.” He was fairly lucky. His farm, near Keswick, was on the edge of the zone inside which all animals had to be killed to stop the disease spreading. He lost only a third of his 1,500 sheep and 30 of his 100 cattle. In north and east Cumbria, FMD was devastating: all animals were slaughtered (see map). And yet, like Mr Cockbain, the county seems to have come through the epidemic much better than expected.

Some recent economic statistics certainly look bad. A report for the North West Development Agency (NWDA) reckons that Cumbria's GDP fell by £220m, or 4%, in 2001.

But other figures tell a different story. The unemployment rate actually fell, from 4% at the beginning of the year to 3.2% at the end, and was on average half a percentage point lower in 2001 than in 2000. Remarkably few businesses went bankrupt. Brian Lightowler, chief executive of Business Link Cumbria, says: “There were the same number of business failures as there usually are.”

This seems odd, as Cumbria depends heavily on farming and tourism. But the government paid about £500m to Cumbrian farmers as compensation for animals which were killed. Quite a few farmers also earned money from clean-up work. Worse affected were farmers who could not move their animals even though the area was clear of FMD. Richard Warburton, near Appleby, was able to carry on selling milk from his dairy herd but reckons he had to spend about £25,000 on disinfection and other measures. “I've had nothing from the government,” he says.

Despite such hardship cases, the local National Farmers' Union reckons that only one or two farms have gone out of business. The worst that seems likely to happen is that some farmers may still decide to retire early if the costs of re-stocking look too high and the prospects for earnings look low. Even if that happens, such farms are likely to be taken over by neighbours.

The tourist trade, however, got no compensation. Visitor numbers fell by 60% as soon as the outbreak occurred. Through the year, the county lost about a fifth of the £1 billion usually spent by tourists. But by September, the Cumbria Tourist Board says, the numbers were getting back to normal. A few businesses, such as those based on Lake Windermere, actually had a bit of a bumper year.

Plenty were clobbered. Worst-hit were those which depend on the hill-walkers who were banned from the peaks between March and August. They survived by cutting staff—an estimated 3,000 of Cumbria's 47,000 tourism-related jobs disappeared that way. These people did not boost the jobless tally because they were mainly seasonal workers who found jobs at places unaffected by FMD, such as the northern coastal resorts.

Many businesses, faced with a 50% drop in annual income, just seem to have battened down the hatches. Alec Graham, who runs one of Keswick's two dozen or so outdoor clothing shops (only two closed) says he survived by living off £50 a week and not using his car. There was some help around. Banks and the taxmen offered payment holidays of up to a year on their bills. Various agencies have shelled out about £24m in grants and loans to refurbish hotel and guest house accommodation and to help businesses market themselves. The NWDA hopes to make another £65m available to Cumbria soon.

The net effect appears to be that while people owe the banks a lot more money, many are better placed to earn more from visitors by having better accommodation to offer and by being able to sell it harder. The tourist board says that about five times more than usual is now being spent on marketing the Lake District. It is optimistic that 2002 will turn out to be an extremely good year. Diane McMeeking, who runs a Keswick estate agency, says that there is a dearth of guest house businesses for sale and that locals are even buying houses to rent them out.

In fact, the only disaster to have happened in Cumbria seems to have been suffered by the government. Hardly anyone has a good word for the way it handled FMD. Farmers complain that it was too slow to ban animal movements and too bureaucratic in its handling of the outbreak. The tourist industry says it was too draconian in imposing countryside access restrictions and too slow to lift them. But not even the government can deliver what Cumbria needs to complete its recovery—some decent weather.

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Manufacturing

Does it matter?

Mar 7th 2002
From The Economist print edition

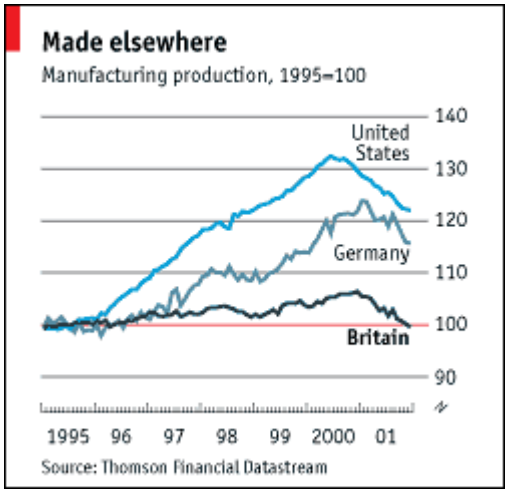
Manufacturing is not special and pleas that it is are special pleading

BRITAIN'S manufacturers are starting to hope that the worst is over. After the most serious fall in output for more than ten years, business surveys are indicating that recovery is on its way. The Purchasing Managers' index recovered sharply in February to a level indicating that the manufacturing sector is now marginally expanding for the first time in a year.

Recovery cannot come a moment too soon. Output fell by 6.4% in the year to December, the steepest decline since the year to August 1991. This collapse in production was on much the same scale as in other major economies, as America's recession rippled out across the world. As elsewhere, the industrial downturn has been concentrated in high-tech (classified as electrical and optical equipment) where output has declined by a quarter since December 2000.

But what has made the plight of the entire manufacturing sector so serious is that this decline came after five years of negligible growth (see chart). By comparison, manufacturing in America and Germany made impressive gains until a peak in 2000. Within Britain, manufacturing's fortunes have stood in stark contrast with those of the services sector, creating the “two-speed” economy. Manufacturing production last year was only 2.7% higher than in 1995, compared with rises of more than 25% for the services sector and 36% in business and financial services. As a result, manufacturing's share of the economy has shrunk from 21.6% in 1995 to less than 19%.

Does this matter? After all, the past six years have been a successful period for the economy as a whole, with low inflation and sustained growth. Manufacturing may have suffered last year, but the economy—spurred by strong growth in business and financial services—still expanded by 2.4%, the fastest growth rate in the Group of Seven major economies.



Unsurprisingly, manufacturers say that their problems cannot be shrugged off so readily. The Engineering Employers' Federation argues that manufacturing is special on two main grounds. It is the “bedrock” of Britain's trade, accounting for three-fifths of exports of goods and services. It is also a dominant source of innovation in the economy. Britain cannot afford for manufacturing to shrink much further, since then it will lose “critical mass”, adds the CBI in a plea for a national strategy for the sector.

The argument about trade is weak. For one thing, manufacturers themselves account for a lot of imports,

both in raw goods and in semi-manufactures. For another, goods and services are not the only way to earn current-account credits. Investment income is another major source. When this is taken into account, manufacturing accounted for 38% of total current-account credits in 2000. There is no reason why faster growth in exports of services should not fill the gap left by a receding manufacturing sector. Britain is the world's second largest exporter of services and such exports, especially in the financial sector, have grown much faster than those of manufactured goods since 1995.

The argument about “critical mass” is even less convincing. It is certainly the case that individual economic activities tend to benefit by clustering in the same locations. As Alfred Marshall, a Victorian economist, noted in 1890: “the mysteries of the trade become no mysteries; but are as it were in the air”. Silicon Valley is a prime example in manufacturing, the City of London in financial services. But it is a jump in logic to apply this locational theory to a sector of the economy as diverse and as large as manufacturing.

The argument about innovation deserves more of a hearing. In principle, a viable manufacturing sector should allow Britain to benefit from breakthroughs in science and technology, driving higher productivity growth. R&D is becoming an increasingly important source of economic growth in advanced economies, according to the OECD. Most business R&D is conducted in manufacturing and industrial firms are one of the main ways of spreading best practices across frontiers, argues Nigel Pain of the National Institute of Economic and Social Research.

The government appears to have taken this message on board. Patricia Hewitt, the trade and industry secretary, says that innovation and technology transfer are a central task for her department. She wants more effective links between industry and universities. The “appliance of science” will be a principal theme of the strategy for manufacturing that the DTI is now drawing up. Gordon Brown, the chancellor of the exchequer, will help by extending tax support for R&D in the budget.

Beyond these steps, there seems no reason to single out manufacturing for special treatment any more than any other sector of the economy. What matters is to have successful firms wherever they operate. If manufacturing firms are doing poorly in Britain, this is in large measure their own fault, reflecting poor management. Labelling one (relatively unsuccessful) portion of the economy as special is a category mistake.

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Bagehot

A bit of a stretch

Mar 7th 2002
From The Economist print edition

Tony Blair thinks Britain is "pivotal". That is why the ungenerous impugn his motives

OVER the past few years, Bagehot has been falling in and out of love with Tony Blair's war leadership. For a man who has been prime minister for only five years, and of a country that thinks of itself as being mostly at peace, he has supervised a surprising number of wars. When you tot them up—Mr Blair has, as it were, seen action in the mountains of Kosovo, the mean streets of Belfast, the jungles of Sierra Leone, the skies of Iraq and the snows of Afghanistan—he begins to look almost like a grizzled veteran. He may not be able to clench a bayonet between his teeth, but he certainly knows a few men who can. He likes generals, and is probably liked even more in return by the junior officers. Under New Labour, would you believe, they get plenty of opportunities to do some real soldiering.

Even so, there is something about Mr Blair's string of campaign medals that makes even his admirers uneasy. With the exception of Sierra Leone and Northern Ireland, a war that Mr Blair has come creditably close to ending, Mr Blair has not been at the very apex of the chain of command. In Iraq he inherited a supporting role: British airmen fly alongside Americans, policing the no-fly zone above Iraq. In Kosovo and Afghanistan, it was again the Americans who did most of the sharp stuff. No shame should attach to playing second fiddle: Mr Blair has said time and again that Britain cannot pretend to be the superpower's equal. But it does mean that his leadership has to be measured in a different way from the leadership of Margaret Thatcher, who was playing solo in the Falklands. Much of his war leadership has been war followership.

Now a British prime minister can send British troops to tag along in America's wars for various sorts of reason. One such would be to lend what help Britain can to a noble cause. Another would be to gain influence over the direction of an American adventure that might otherwise develop in a way that damages Britain's interest. This is probably worth doing too, though it smacks more of realpolitik than of high moral purpose. These compartments are not watertight. Most of Mr Blair's foreign entanglements, as in Kosovo and Afghanistan, have been a mixture of both, with the complication that Kosovo was a case of America going to war as a favour to Europe.

Bagehot cannot help loving Mr Blair when his war leadership tends towards nobility rather than influence. In 1999, the prime minister was so shocked by the plight of Kosovo's fleeing Muslim refugees that he risked falling out with Bill Clinton in his desperation to make sure that they would eventually return to their homes. There was nobility as well in Mr Blair's instinctive decision to report in for duty the instant after Osama bin Laden struck America. In this case, however, he also foresaw that the world might never be quite the same again, and that the superpower would for years to come judge its friends by their behaviour in its hour of need. Still, a noble cause allied to national self-interest: who can complain about that?

What, though, of a prime minister who sends British forces along to America's wars not in order to contribute to a noble cause, nor to influence the outcome of a particular adventure, but because tagging along with America is just something that Britain always does in order to elevate its own standing in the world? Bagehot is not certain whether this fits Mr Blair, but he knows some people, mostly Labour MPs, who are.

In Parliament this week, MPs attempted to hold a debate about whether Britain ought to join America if the next phase of the war against terrorism were to be an attack on Iraq's Saddam Hussein. The debate did not get very far. A Labour Foreign Office minister accused a Labour backbencher, George Galloway, of having made his career out of being "not just an apologist but a mouthpiece for the Iraqi regime". The backbencher called the minister a liar, whereupon the debate was suspended. But it is plain to party managers that Mr Blair has a revolt on his hands. Fifty Labour MPs have already signed a motion

expressing deep unease about the possibility of a war against Iraq.

Bad timing

The prime minister denies that any decision has been taken, in Washington or London, on what to do about Iraq. But he has suffered two misfortunes. One is timing. The moment Mr Blair began to write articles and make speeches softening up public opinion for stern action against Iraq, Mr Bush fired the first shot of what could become a trade war between Europe and America, stirring the wrath of Labour's plentiful anti-Americans.

Mr Blair's second misfortune is one of his own making. Long before September 11th, but with increasing stridency since then, he has been advancing a theory about the “pivotal” role that Britain can play in world affairs. One of the chief ideas in this theory is that Britain's possession of efficient armed forces, together with its twin loyalty to America and the European mainland, give it a unique bridging role. A few months ago, European governments anxious about America's intentions began to take this argument seriously. Perhaps Britain's close military relations with America really would enable Mr Blair to influence Mr Bush's decisions. Perhaps, for example, he would be able to talk Mr Bush out of a new adventure in Iraq.

Perhaps. But what seems more probable is that Mr Bush has already decided to remove Mr Hussein and Mr Blair has already decided to help him. Bagehot hopes that this is because the prime minister sincerely believes that ridding Iraq of a murderous dictator seeking weapons of mass destruction is a noble cause, or hopes to influence the way this necessary operation is conducted. But a lot of ungenerous people are liable to conclude that Britain would have tagged along whether the cause was noble or not, simply because Mr Blair sees tagging along with America as part of what keeps Britain great. That's what happens when you talk too much about being “pivotal”.

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Back to basics

Mar 7th 2002
From The Economist print edition

In these less exuberant times, managers need to remember a few old-fashioned virtues, says Tim Hindle

IF BAD times make good leaders, America is due for a host of them. The recession that began in March last year and the terrorist attacks on September 11th made 2001 an unforgettably awful year. At such times people react strangely. Some are frozen in indecision while others act with unnecessary haste. Across large corporations, such behaviour, multiplied many times, can be disastrous. At times of crisis, having the right people in the right place is vital. In a boom there is enough fat to absorb some bad judgment; in a recession good management becomes a survival issue.

Dave Young, head of the Boston Consulting Group's Boston office, maintains that for many companies the downturn will turn out to be a blessing. “It means that, increasingly, value in the capital markets will accrue not to ‘irrational exuberance' or to sector hype,” he says, “but to good management.” But what, in such circumstances, constitutes good management? It is certainly not something that can be conjured up out of the blue. Companies that have it now had it in good times too, and found it useful then; the difference is that in today's harsher climate it has become essential.

This survey suggests that the core of good management is a set of three old-fashioned virtues that were often forgotten in the bubble years, when anything seemed to go. At a minimum, good managers have to meet the following criteria:

• be honest;

• be frugal;

• be prepared.

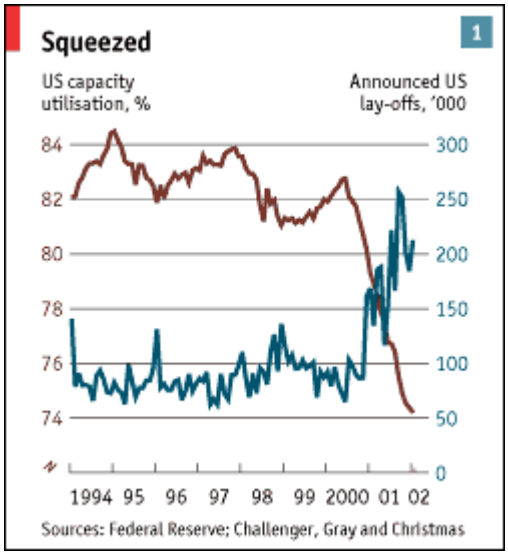
For many managers, that may sound about as exciting as shopping in Wal-Mart when they have become accustomed to Bloomingdale's. But deep down, they know where they get the better value.

Essential virtues

Being honest, of course, is not just a matter of keeping within the law. Most managers do that, which is why the few who step outside it receive so much attention. For the law-abiding majority, it is a matter of escaping from self-delusion. That requires setting up systems in which rewards are not related to numbers which can be massaged and exaggerated at will.

Above all, it is a matter of being honest about a company's value and its potential. Warren Buffett, the chairman of Berkshire Hathaway and one of the most successful “value creators” in American business over the past 20 years, wrote in one of his celebrated annual letters to shareholders: “We do not want to maximise the price at which Berkshire shares trade...we wish for them to trade in a narrow range centred at [their] intrinsic business value.” Managers need to think about what is their own

company's “intrinsic business value”. And so do the investment bankers, analysts, consultants and the rest on the merry-go-round of business hype.



In a similar vein, being frugal is not just a matter of cutting costs in a downturn. It is a question of being sparing with resources at all times, of continually looking for new ways to cut costs, and of creating an atmosphere in which waste and excess are unacceptable, no matter what the market conditions. The extremes to which Wal-Mart's managers take this—such as sharing bedrooms on business trips, and being expected to bring back free pens from conferences—may be counterproductive, to the point of repelling able managers. But the enduring success of many businesses—from Andrew Carnegie's and J.P. Morgan's in the 1900s to Warren Buffett's and Sam Walton's today—have been built on a frugality bordering on stinginess.

To those brought up in this traditional mould, the wild extravagance with which many dotcoms set about implementing their business plans in the late 1990s seemed to doom them from day one. Before their online start-up had sold a single rag, the founders of boo.com, an Internet clothes shop, had splashed out on a small army of Gurkha bodyguards, rivers of champagne and rows of seats on Concorde to attend meetings with their investment bankers. Fleets of Webvan vehicles, some having made scarcely a journey for the failed online grocer, now sit for sale in parking lots, silent witnesses to their owners' waste of over $1 billion. In an economy where profit is no longer the yardstick of commercial success, it can be hard to find reasons to control costs.

Lastly, managers need to return to the idea that it is worth planning for the future. “Chance favours only the prepared mind,” said Louis Pasteur, the 19th-century French chemist. In America's previous recession, in the early 1990s, the enthusiasm for downsizing—taking out whole layers of management—hit corporate planning departments particularly hard. Many had made themselves easy targets by concentrating too much on the financial minutiae of future plans that might or might not be implemented, rather than looking at the broader picture.

Planning was further undermined by the myths surrounding the so-called “new economy”. Its champions seemed to dismiss planning, saying that business had to think differently not only about today but also about tomorrow. In a world where change was said to take place at the speed of light, and where even mighty Microsoft could have its markets usurped by an unforeseen upstart in less time than it takes to launch a new version of Windows, looking ahead beyond the next dollop of venture capital seemed pointless. Why be prepared, the argument went, when nobody knew what to be prepared for?

Today, many companies—including giants such as Nokia, Hewlett-Packard and EDS—are once again taking strategic planning seriously. Some never abandoned it. At Emerson, a remarkable engineering-based business in America's mid-west (of which more later), planning has always been a top priority. Its chief executive spends 60% of his time meeting heads of divisions to discuss and challenge their plans. In good years and bad, the company is prepared for most eventualities.

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How was it for you?

Mar 7th 2002
From The Economist print edition

AP

No two recessions are the same—and each has winners as well as losers

THE recent recession in America and elsewhere has been peculiar in several important respects. Some forecasters thought that globalisation might make this the first worldwide recession in history, but economies the world over still seem to be moving at their own pace. On the most widely accepted definition, it takes two successive quarters of negative growth for a recession to kick in. In that sense, both Germany and Japan experienced a recession in the second and third quarters of 2001. But America saw negative growth only in the third quarter, France in the fourth, and Britain has yet to see a single quarter of negative growth since the start of this decade. Taiwan and Singapore, heavily dependent on the semiconductors that fuelled the IT boom in America, saw their economies shrink in 2001, but nearby Thailand and South Korea recorded positive growth, albeit a good deal lower than the year before.

The recession in America, unlike that in Japan and Germany, followed a period of extraordinary growth and ebullience, when even badly run companies could survive without much effort. That made its effects all the more traumatic. So long-lived had the bubble been that managers at first refused to believe it had truly burst. In the early months of 2001, many stood and waited, hoping that the evidence of a slowdown would just go away. For some, the hesitation was fatal.

Then, just as the reality of encroaching recession began to hit home, the terrorist attacks on the World Trade Centre and the Pentagon blasted consumer spending. In October, financial inducements from desperate car makers maintained some semblance of normality, but in November retail sales dropped by 3.7%, the sharpest month-to-month decline since 1992.

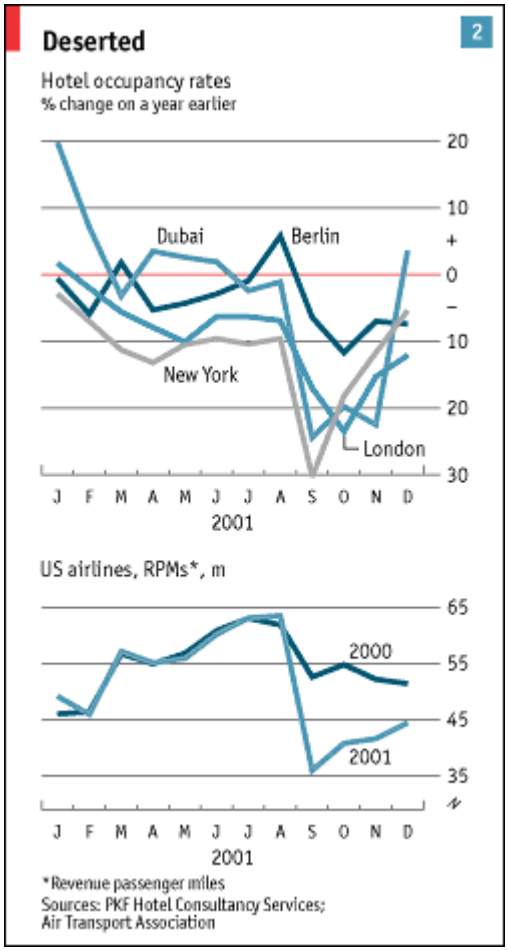
In a number of ways, the recession also differed from earlier downturns in America itself. For one thing, it happened at a time when inflation was historically low, which made the restructuring of troubled companies with high levels of debt that much harder. In deflation-ridden Japan, this has been an important reason for the economy's inability to pull itself out of the dumps.

In America, corporate debt as a proportion of profits is at record levels, but this is less of an issue than it was in the recession triggered by the Gulf war in 1990-91. America Inc's gearing (the ratio of debt to equity) peaked in September 1990, at 91%. After more than a decade of equity worship, by the middle of last year

that figure had dropped to 77%. Over the same period, corporate liquidity (the ratio of companies' short- to long-term debt) also improved. The finances of a number of American firms are in sufficiently good shape to allow the well-managed ones to take advantage of the misfortunes of those that are weak and over-leveraged.

In addition, firms in Europe and America say their bankers have been more understanding this time round than they were in the 1990-91 recession. On that occasion, many banks foreclosed early on failing firms and sold off their assets as quickly as possible. Not only did that create an unwelcome political backlash, it also left banks regretting their haste soon afterwards. As the economy picked up, they watched many of their recently sold assets rapidly climb in value.

Recessions do not dole out their misery evenly. Consumers no longer shop until they drop; they shop until they drop that particular shop. In a recession, they become more price sensitive and more inclined to seek out discounts. Online retailing in America continued to grow strongly throughout the downturn as consumers surfed for bargains from firms such as eBay. This auction site, a favourite with bargain-hunters the world over, saw its revenues increase by 64% (and its net income by 8.7%) in the last quarter of 2001. While sales at low-price Wal-Mart rose, upmarket Bergdorf Goodman reported a steep decline.



Some sectors will always avoid recessions or even benefit from them—bankruptcy lawyers, for instance, or outplacement firms. In a study of 377 large American companies during the industry slumps and economic recessions of the 1980s and 1990s, Bain & Company, a firm of strategy consultants, found that in any one recession only 60% of all industrial sectors were actually in a downturn.

And the winners are...

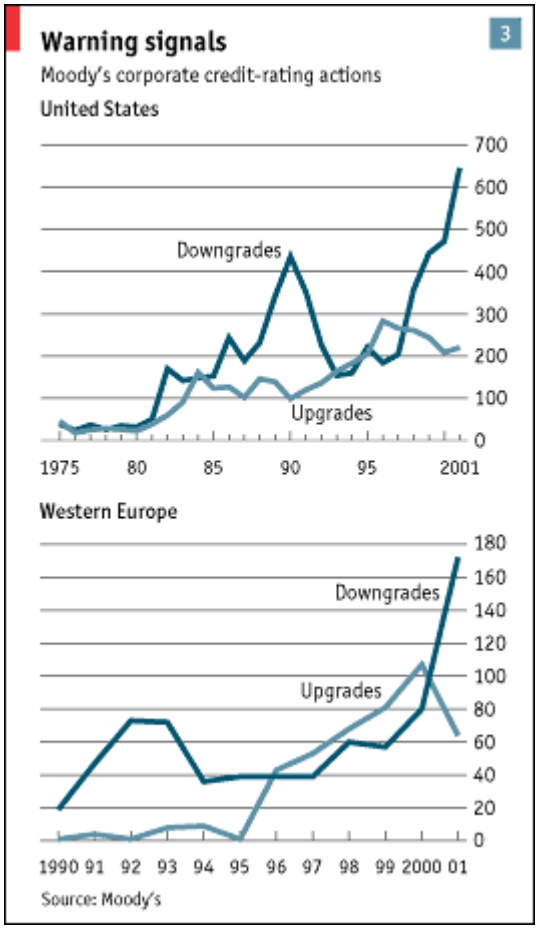
Some of the beneficiaries of recession are much less obvious than bankruptcy lawyers. In November last year, for example, Estée Lauder, a cosmetics firm, reported exceptionally strong sales of its lipsticks. It seems that lip-colouring provides women (and some of the men who will be looking at them) with a bit of cheap and instant cheer when times are gloomy.

Campbell Soup had a great year too. Its sales in the quarter to the end of October 2001 were up by 9%—quite a jump for such a conservative product. Some of it was due to extra advertising and the launch of new products, but the company says its base business grew by 5%. Bottled water also benefited as housewives lost faith in their government's ability to protect their water supplies from contamination. So too did packaged meals as Americans, who normally eat out a lot, decided it was safer and cheaper to stay at home.

Even in a downturn, some geographicals areas can do well while others suffer. The Port of Los Angeles emerged from the 1991 recession as the busiest in America, having invested heavily to take advantage of the job losses at the city's declining aerospace industry. In 2001 it had another successful year.

Sectors hit particularly hard in the latest recession range from telecoms and casinos to steel, but none has suffered more than the travel and tourism industry. As a general rule, international tourist journeys and hotel occupancy closely follow overall economic activity. When GDP slows down, so do they. But this

time the fall has been precipitous. Immediately after September 11th, hotels around the world looked as if they had been evacuated. From Muslim tourist destinations such as Egypt and Indonesia to business centres such as London, New York and Paris, lobbies echoed to the sound of cancellations. PKF, a tourism consultancy, reported that the average yield of a hotel room in London last October was 33% down on the year before. An American firm, Smith Travel Research, estimated that in the same month the average price of a hotel room in New York city was 27% lower than a year earlier. Room rates at some luxury hotels in the city, the hardest hit of all, were slashed by more than 50%.



Planes had been rattling half-empty around America's skies long before September 11th. Those used as bombs on that fateful day were far from booked out. After the terrorist attacks almost nobody wanted to fly any more, which meant the airline industry faced the worst crisis in its history. During 2001, aircraft were being "retired" at more than twice the normal rate to gather dust expensively in places such as the Arizona desert.

Along with other deeply distressed industries, the airlines and travel operators quickly turned to their governments for assistance. Two months after the attacks, the World Travel & Tourism Council (WTTC) complained to the EU that its calls for help were not being taken sufficiently seriously. Jean-Claude Baumgarten, the WTTC's president, declared himself deeply unhappy with the EU's overall conclusion "that the impact [of the crisis] will be neither significant nor prolonged, and that long-term strategic policies will be sufficient for the industry to recover."

Even after receiving state aid worth over $2 billion, the big American airlines, including American and United, whose aircraft were hijacked on September 11th, between them lost $2.6 billion in the third quarter of 2001. The fourth quarter was even worse, with US Airways alone losing $1 billion, and American and Delta over $700m each.

Instant morale-booster

In Europe, the picture for the industry was scarcely less gloomy. Swissair and Sabena, the Swiss and Belgian national carriers, collapsed into bankruptcy soon after the attacks. Airlines such as British Airways and Virgin, heavily dependent on the north Atlantic routes, where traffic fell by over 35% in the aftermath of the hijacks, made heavy losses.

But even within these distressed industries, there were some bright spots. Cut-price operators such as Southwest in America and Ryanair and EasyJet in Europe suffered far less than others. Southwest even made a small profit in the fourth quarter of last year and managed to avoid laying people off immediately after the events of September 11th. What the low-cost carriers lost from the public's new aversion to travelling on planes, they made up from its new determination to find value for money.

In the 1990s, America enjoyed its longest continuous period of growth since the 1960s, which meant that by 2001 corporate America had little collective memory of recession. Stuart Grief, a vice-president of the Boston Consulting Group, says many managers found it as difficult to cope with "as their first hangover in college". Bain reckons that only 20% of the chief executives in office in the recession of 2001-02 had been leading their companies in the previous recession.

Short memories

Some companies sought to make up for the lack of experience by bringing back old troopers who remembered harder times, or promoting people who had lived through recession elsewhere—for example, in East Asia in 1997-98. General Motors hired Bob Lutz, now 70, to head its American

operations. Mr Lutz is famous in the car industry as the man who brought Chrysler back to life during the downturn of the early 1990s.

However, there is no guarantee that someone with experience of a downturn will do better next time. In a survey carried out in 1999, Bain asked senior managers what was the most important lesson they had learnt from the recession of the early 1990s. Far and away the most common answer was, “I don't know.”

That seems surprising. True, no two recessions are the same, but some things come round again, and some lessons can be learnt. In “Coping with Recession: UK Company Performance in Adversity” (Cambridge University Press, 1997), Paul Geroski, a professor at the London Business School, and Paul Gregg, a research fellow at the London School of Economics, reported on a large study of British companies in the recession of the early 1990s. One of their main findings was that: “The effects of recessions are highly skewed, with a relatively small number of firms suffering particularly badly.” Moreover, “The rankings of firms seem to be scrambled during recessions to a degree which does not occur in other periods.”

“Recessions”, says Mr Geroski, “are about what happens to differences between firms much more than they are about what happens to firms on average.” For many firms, this latest downturn represents not so much a threat but a great opportunity to steal a march on less competent competitors.

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Why honesty is the best policy

Mar 7th 2002
From The Economist print edition

Corporate deceit is a slippery slope

AP

Play it straight, says Buffett

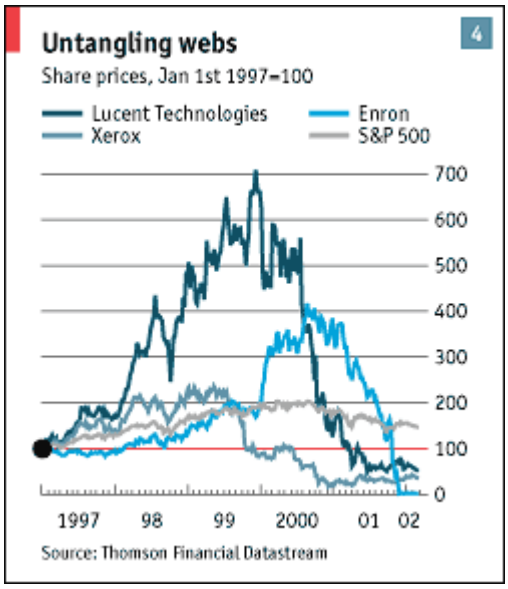
FOR every corporate crook there are at least ten corporate deceivers: people who fool themselves that things are other than what they appear to be. At first they do not break the law, but eventually they find that corporate deceit is difficult to sustain. “Oh what a tangled web we weave when first we practise to deceive,” wrote Sir Walter Scott in 1808. He might have been talking about Enron, Lucent, Xerox or any of the other big corporate deceivers that have come to light in recent years.

Deceit demands more deceit until eventually the pile collapses under the weight of its own incredibility. As Warren Buffett puts it, “Once a company moves earnings from one period to another, operating shortfalls that occur thereafter require it to engage in further accounting manoeuvres that must be even more ‘heroic'. These can turn fudging into fraud.”

The most outstanding recent example of this is Enron, an energy-trading company as widely praised as any online wonder at the height of the Internet euphoria. Analysts loved it. One predicted that it would come to dominate the wholesale market for electricity, natural gas, coal, energy derivatives and bandwidth, and on three continents. Investors loved it enough to value the company at $28 billion in October 2001, less than two months before it skidded into bankruptcy.

The media also loved it. Without irony, *Fortune* magazine voted it “The most innovative company of the year” for 2000. And *The Economist*, for its sins, wrote at the end of June last year that “Enron has created what may be the most successful Internet venture of any company in any industry anywhere”—noting that the banner which greeted visitors at Enron's Houston headquarters had recently been changed from “The world's leading energy company” to “The world's leading company”. Rarely has pride come before a bigger fall.

Above all, though, consultants loved it. In “The War for Talent” (Harvard Business School Press, 2001), Ed Michaels, Helen Handfield-Jones and Beth Axelrod wrote that: “Few companies will be able to achieve the excitement extravaganza that Enron has in its remarkable business transformation, but many could apply some of the principles.”



The authors, all consultants at McKinsey, heaped particular praise on Jeff Skilling, a former McKinsey consultant who became Enron's CEO. In August 2001 he suddenly resigned from Enron “for personal reasons”. Mr Skilling tried to weld a new culture on to an established firm by recruiting fast-track MBAs and traders. It turned out to be an explosive formula.

It was not that Enron lacked substance, but in the end the hype got the better of it. To meet the outside world's unrealistic expectations, it began to fudge the figures. To disguise its liabilities, it wrapped them up in private partnerships and took them off its balance sheet. And to satisfy the wishful thinkers' insatiable demands, it brought earnings forward by selling shares in other off-balance-sheet partnerships, and counting the proceeds as revenues.

When this deceit was no longer sustainable, the company was obliged to restate its earnings, which

caused its collapse. “My hypothesis”, says Michael Jensen, a former professor at Harvard Business School and now a director at the Monitor Group, a strategic consultancy, “is that they overreached to try to become all things to everybody, to become the world's greatest company. No one can grow that fast.”

Not all corporate deception is on the scale of Enron's, but even when it is little more than the equivalent of a white lie, it is still dangerous. Take eBay, one of the few really successful businesses to have grown out of the Internet. It has a reputation for giving conservative financial forecasts to Wall Street analysts, so they have taken to second-guessing the company and marking up its forecasts. That puts eBay under pressure to hit targets it had not considered itself capable of achieving. Yet if it fails to reach them, Wall Street may well forget that they did not come from the company in the first place.

Reuters

Pride came before Enron's fall

Storm warning

Early this year, eBay was levitating on a projected p/e ratio of over 90, a number that reflects investors' colossal expectations about its future earnings. Any slight disappointment could deal the share price a disproportionately large knock. Because of all the other things that depend on a company's share price these days, such a knock can bring a company down. From the flapping of a butterfly's wings, a huge tornado can arise.

In recent years, corporate dishonesty has been encouraged by the availability of easy money. The finance industry is more given to herd-like behaviour than any other. Its bosses always imagine that their rival down the street has just stumbled upon the perfect way to make risk-free profits. Venture capital, private equity, commercial mortgage-backed securities, private partnerships...the list of ways of throwing money at risky ventures faster than the competition is constantly being replenished.

One main cause of the dotcom bubble was the immaturity of the venture-capital industry. It had nothing like the resources needed to monitor the businesses in which it was investing other people's savings, so it was flying half-blind. A firm with more money and promise than performance—and there were plenty of those in the late 1990s—has a limited range of choices: it can return the money; it can be more realistic about the promise; or it can lie about its performance.

One main cause of the dotcom bubble was the immaturity of the venture-capital industry

A number of venture-capital firms are now trying to build up their expertise to give their investments a better chance. Paul Gompers, a professor at the Harvard Business School and co-author of “The Money of Invention” (Harvard Business School Press, 2001), argues that the venture-capital industry is going through the same growing pains as investment banking 40 years ago.

Meanwhile, it has become harder than at any time in the past decade for good business ideas to find seed capital in America. For example, a start-up called FluidSense, based just outside Boston, invented an infusion pump to drip fluids into hospital patients that allows them to walk about instead of remaining bedbound. In 2000 this was one of *Time* magazine's top inventions of the year; by October 2001 the company was bankrupt, unable to find the capital to keep it going.

“The venture-capital industry has been prone to overshooting,” says Mr Gompers. Herd-like behaviour ensures an alternation of feasts and famines. For the moment it is famine time, caused by yesterday's self-delusional feast.

Dangerous games

A number of things can be done to encourage corporate honesty and help to counteract the powerful urge to deceive. Mr Jensen and the boss of the Monitor Group, Joe Fuller, have been arguing—in the *Wall*

Street Journal and the *Harvard Business Review*, among other places—that the dialogue between chief executives and Wall Street must change. Bosses need “to put an end to the expectations game by simply saying ‘no' to what has euphemistically been termed ‘earnings guidance',” they wrote recently. Mr Fuller says that the recession in America “gives companies an excellent opportunity to reset the conversation on a number of levels.”

A few have begun to set an example. George David, the chief executive of United Technologies, stood his ground last December when analysts criticised his “conservative” target for the group's earnings in 2002. “You've left yourself a self-imposed hurdle that you can clearly jump over without expending much energy,” complained Howard Rubel, an analyst with Goldman Sachs. That criticism carries more weight today than it used to because a growing number of people stand to lose out from a low hurdle, including managers themselves (through share-option schemes) and employees (through their pension funds, which invest more and more in their own company's shares). James Kilts, who became boss of Gillette just over a year ago, went one step further. At his first full meeting with Wall Street analysts in June last year, he ridiculed earlier forecasts that Gillette's earnings could grow by 18% a year and resolutely refused to give an earnings forecast himself.

It is not just that a company's managers need to be honest about their performance: investors also need to take a more dispassionate view of what they are told. In December, America's Securities and Exchange Commission gave a warning to investors that pro-forma earnings reports should be “viewed with appropriate and healthy scepticism”. Such figures are produced by companies for a variety of purposes and are not usually audited by their external accountants.

The high-tech industry has made extensive use of pro-forma accounts to pump up its results. SmartStockInvestor.com, an online analyst, reported recently that for the first three quarters of 2001, the 100 companies in the Nasdaq 100 index announced pro-forma profits of $19.1 billion. Yet when the figures were processed in line with America's generally accepted accounting principles (GAAP), which companies have to use in their audited accounts, that “profit” became a loss of $82.3 billion. The Nasdaq 100 includes companies such as Microsoft, Intel, Cisco Systems, Oracle and Dell. Of these, only Oracle's pro-forma results bore any resemblance to its GAAP figures. Cisco's pro-forma profit of $700m translated into a GAAP loss of $3 billion.

Others trying to escape from the guidance game include USA Networks, an online retail and entertainment group run by Barry Diller. In a filing with the SEC last October, the company said that it “has decided to change its approach to the ‘guidance' ritual”. For this and subsequent years, the company “will provide the investment community with our actual internal budget, broken down by business segments...it's a far more productive process than trying to manage the Street.”

Yet the internal budget process itself involves a fair amount of self-deception. An article by Mr Jensen in the *Harvard Business Review* last November starts off: “Corporate budgeting is a joke, and everyone knows it.” In any organisation, costs and revenues can be shifted easily from one period to another. Sales can be brought forward into the current period, for example by announcing in advance that there will be big price increases early in the following period.

Mr Jensen argues that “traditional budgeting processes waste time, distort decisions and turn honest managers into schemers. It doesn't have to be that way—if you're willing to sever the ties between budgets and compensation.” Too many managers' rewards are tied to meeting targets and goals embedded in the budgeting process. In recent years these targets have been made ever harder to achieve. Setting so-called “stretch goals” has become almost the norm in business today. For example, General Motors' purchasing boss, Harold Kutner, recently explained that the company's hoped-for cost savings of $4 billion in 2002 was a stretch goal.

In good times these ambitious targets encourage managers to fiddle the figures so that they are achieved, just. In an economic downturn, when the targets move completely out of reach, those same managers are persuaded to fudge the figures in the opposite direction. They bundle as much bad news into the current period as possible, aiming to make their targets easier to achieve in the next. This is known as the “big bath” approach to corporate accounting. If you are going to make a loss, it might as well be a big one. Either way, the process fosters dishonesty and exaggerates corporate success and failure. The good times are made to look better than they are, the bad times worse.

Encourage whistleblowers

Another thing companies can do to counter dishonesty is to encourage whistleblowers—people who draw attention to suspected corporate malpractice. Regrettably, whistleblowers today are treated as pariahs almost everywhere. Recent cases in Australia, Britain and America involving well-known companies such as Coles Myer, BP and Xerox show how common it is for those who report wrongful activities to be bullied and harassed for their pains. They are often sacked without compensation and suffer great stress from battling alone. They get very limited protection from the law. Billy Garde, a Washington lawyer whose firm handles many whistleblowing cases, says that in the public sector the people concerned “have fewer rights than prisoners”.

A few companies, such as Abbey National, a British bank, take the issue seriously. Abbey produces a booklet, “Addressing Employee Concerns at Work”, which provides lots of contacts, both inside and outside the organisation, for employees who are worried about malpractice. Just as important, it gives out the message that honesty is rewarded by the organisation.

Unless that message is conveyed continually, companies risk finding that it is too late to turn honest. At Enron, for example, some staff did express concern about its accounting practices before the company spiralled into bankruptcy. Last August, for example, Sherron Watkins, one of the firm's accountants, wrote to Kenneth Lay, Enron's founder and then chairman, about the company's accounting irregularities. Presciently, she said she was afraid that the firm might “implode in a wave of accounting scandals”.

The haste with which the firm's auditor, Andersen, shredded evidence when the company's troubles came to light suggests that Enron's “irregularities” were not acceptable under current accounting rules. But the main point is that the Enron case, and a long list of others before it, have undermined faith in companies' published accounts, and in their external auditors' pledge that these accounts represent a “true and fair view” of the companies' financial condition.

Even the accountants themselves admit as much. Joseph Berardino, Andersen's chief executive, told a congressional committee investigating Enron's collapse: “I believe that there is a crisis of confidence in my profession...Real change will be required to regain the public's trust.”

The crisis goes beyond the numbers. Business plans are increasingly being shaped by the nature of accounting rules and the extent to which they can be bent. Paul Volcker, a former chairman of the Federal Reserve and now chairman of the board of trustees of the International Accounting Standards Committee, says that: “The accounting rules are driving the business model.” The cart is pulling the horse.

This is not a new problem. Accounting mirages played a big role in some of the flimsier go-go stocks of the 1980s. Polly Peck, for instance, a British conglomerate with big interests in places such as Turkey and Northern Cyprus, where inflation was high, managed to amplify its earnings by careful use of the rules on accounting for foreign exchange.

Trust me, I'm an accountant

The crisis for accounting today is more serious than 20 years ago because accountants have become such an integral part of the system they are supposed to be independently vetting. For example, Enron paid Andersen $52m in 2000—$25m for auditing and $27m for consulting services. The success of Andersen and the size of its pay packets depended crucially on Enron, its biggest single client until the company sacked Andersen in January this year. Accountants face the same temptation to play dangerous games as their clients, whose accounts departments are often filled (as they were at Enron) with their auditors' ex-employees. They all know how to play.

One way out would be to spin off the key task of auditing the auditors to a government body or an independent organisation. At the moment, the industry is largely self-regulating. Senior partners at some of the Big Five accounting firms would rather welcome such a move. Firms such as Ernst & Young, which have sold their consulting practices, see little financial gain from hanging on to auditing.

But whoever watches over it, auditing will remain as much an art as a science. Accounting precision is an elusive goal. A company's earnings measured under American accounting rules, for example, can be twice as high as under British rules, without any bending at all. In the end, it is up to managers to come clean about what they feel is the true value and potential of their company. They have to be honest with analysts and honest with their auditors, but first of all they have to be honest with themselves.

Senior managers at consistently excellent companies such as Emerson and GE seem to be able to question each other's assumptions without undermining each other's confidence or authority. Any manager anywhere would like to believe that the next bright idea somebody thinks up on a Friday afternoon will revolutionise his company.

But revolutions are rare, and the sort that make money even rarer. As Monitor's Mr Fuller puts it: “Long glorious weekends can easily be mistaken for the way the world should be. It's like being in London in June and assuming the city has a sunny climate. It's a sampling error.”

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Feeling frugal

Mar 7th 2002
From The Economist print edition

Cost-cutting is not just for downturns, but for always

AP

The plainer the better

AT THE first whiff of recession, a company's knee-jerk reaction is to cut costs—chop inventory, staff, capital-spending plans, anything you can lay your hands on that does not immediately reduce cash flow. The easiest thing to do is to send out an edict to trim expenses by 20% across the board. But that raises an age-old quandary: how to cut costs in the short term without endangering potential in the longer term?

What has helped many companies to control spending in this recession has been the fall in two big cost elements: interest rates and energy prices. The Federal Reserve Board cut its key federal funds rate 11 times in 2001, from 6.50% to 1.75%, and the price of oil has fallen by 30% in the past year. This gave a helping hand to hard-hit hotel groups, which are often highly leveraged and use a lot of energy, as well as battered airlines, with heavy bills for fleet finance and aircraft fuel.

Many firms made cuts across a broad swath. According to Rick Wagoner, the chief executive of General Motors, “Our entire company is concentrating on reducing costs. We've targeted significant reductions in material and structural costs for 2002, in addition to reducing non-product-related capital expenditures.” Ford slashed its dividend, eliminated managers' bonuses and consulted the trade unions about containing health-care expenses and other benefits.

Where companies homed in on specific areas, the first thing they tackled was discretionary expenditure such as travel, training and product development. Philips, a big Dutch multinational, cut a variety of overheads, including human resources and IT. After the disillusionment with dotcommery, IT became an easy target for many others too. Customer relationship management (CRM) systems, which had caught on with big companies despite the high cost, were an early casualty. Many users already felt that the systems promised more than they could deliver.

Capital-spending plans were slashed. American Airlines cut its proposed capital expenditure by $2.5 billion, postponing the delivery of new aircraft and extending the working life of its existing fleet. Hotel chains reined back on refurbishment and building programmes. For example, Accor, a big Paris-based travel and hotel operator, put off plans to open new upmarket Sofitel hotels in Dallas and San Francisco.

Advertising budgets were hit particularly hard. In America, expenditure on advertising fell by 4.5% last year, the biggest annual fall since 1938, albeit from a buoyant 2000. Traditional media such as magazines and television suffered more than the new online media as marketing managers tried to catch stay-at-home consumers surfing for bargains on the net.

Some analysts say advertising space at the beginning of 2001 had become overpriced, which made the drop seem all the more devastating. Michael Silverstein, head of Boston Consulting Group's consumer practice, says that TV advertising rates in America rose by 40% between 1995 and 2001, whereas “delivery” (new sales per viewer) declined over the same period.

REX

It was the job cuts, however, that caught the most attention. In America, layoffs in 2001 were as big as in the previous three years put together, and the fall in total employment was two-and-a-half times that in 1991. They came fast and furious, not only in America but in Europe too. American and European airlines between them shed some 200,000 staff; Boeing announced plans to lose 30,000 jobs; and Britain's Marconi cut 10,000. Firms

have found it considerably easier to make people redundant in this recession than they did in the early 1990s. Then the cultural view was that you couldn't lay off middle managers. “At many big companies, downsizing loosened the bonds of loyalty between employer and employees,” says Ron Nicol, the head of Boston Consulting's American business.

What clustering is for

No one is safe

The new climate also encouraged companies to look for cuts all the way up the management pyramid, sacking even chief executives with aplomb. For instance, Jacques Nasser at Ford and George Simpson at Marconi were removed after short spells in posts that ten years ago would have been considered secure for at least a decade.

Companies tried to save on employment costs in other ways too. American Express, which had to evacuate its downtown Manhattan headquarters after the September 11th attacks, not only laid off about 15% of its total workforce during last year but also cancelled “merit raises” for its remaining employees. It was one of many companies where the only bonus in 2001 was for employees to keep their jobs. A few firms (such as America's Tribune newspaper group) went further, cutting their managers' salaries.

American companies have more freedom than their peers in other countries to make quick savings by reducing their workforce. Almost all non-unionised workers are “employees at will”, meaning they can be fired at the “will” of the employer. Europeans are shocked by the ruthlessness with which American firms slash jobs. In France earlier this year, the Constitutional Council decided to trim new legislation designed to make it even harder for French employers to lay off workers. It was, the council said, “a manifestly excessive attack on freedom of enterprise”. France's socialist prime minister, Lionel Jospin, did not like it. “Freedom of enterprise”, he reminded his country's industrialists, “is not the freedom to sack people.” But he is powerless to overturn the court's ruling.

Some employers handled last year's job cuts in remarkably insensitive ways. For example, at Cap Gemini, a software firm, employees were informed by voicemail that they had lost their jobs. Such treatment not only generates ill-will among those who leave, which can be damaging to the firm's reputation; it also disheartens those who remain—who are already left to cope with so-called “survivor guilt”. “Don't underestimate the effect survivor guilt has on productivity,” says McKinsey's Helen Handfield-Jones.

The key to making orderly cuts in a downturn is consistency. “Costs do have to be carefully managed,” says Bain's Darrell Rigby, “but a company shouldn't act one way in good times and another way in bad times.” Kulwant Singh and George Yip, professor of international management at the London Business School, confirmed this in a study of the Asian recession of 1997-98 (“Strategic Lessons from the Asian Crisis”; *Long Range Planning*, October 2000). They found that, “While we are not certain that investing in partners will offer large returns, we are sure that the failure to support them during crises will be remembered.”

Support for partners was central to Chrysler's successful management of the recession in 1991. Mr Rigby explains that the Detroit car maker, “rather than forcing suppliers to share the pain...developed closer relations with them...If suppliers suggested ways to cut costs by 10%, they got half the savings.” Ten years on, Chrysler seems to have forgotten much of that lesson. At the moment, of all the big car makers it is GM that is gaining praise for being the least confrontational with its suppliers. This may be an early reflection of Mr Lutz's arrival.

Clusters of greed

In part, the painful cuts in the downturn reflected excessive expectations built up in happier times. For example, the demands for huge rewards on Wall Street are fed by rumours of other Manhattanites' pay packets. Much has been written about the benefits of industries “clustering” together, as they do in Hollywood, Silicon Valley or the City of London. Less has been said about the disadvantages—for example, the easy spread of jealousies among highly competitive people working in close proximity. It is remarkable how sulky senior managers can become when denied perks they think their rivals enjoy.

A generous pay deal won by United Airlines' pilots back in 2000 made the American airline industry that much more vulnerable to the crisis caused by September 11th. When pilots at other airlines heard about the details of the deal, they set out to renegotiate their own contracts to make them at least as generous as United's. But as Raymond Neidl, an analyst with ABN Amro, a Dutch bank, said of the original United deal, “That contract wasn't economic reality and set off a potentially ruinous feeding frenzy.”

Packing them in

Airline pilots may have been intent on ruining themselves, but their passengers were not. *Aviation Week*, a leading industry magazine, reported late last year that “executives of small- to mid-size companies no longer hesitate to abandon mainstream airlines if no-frills, low-cost competitors offer alternate services.” When the airline industry was slashing jobs after the September 11th attacks, low-cost, no-frills Southwest notably laid off no one. In bad times as well as good, jobs are more secure in frugal organisations.

Several low-cost airlines have been seizing opportunities opened up by the recession to expand their routes and their services. When Air Lib, a French regional carrier that emerged from the debris of Swissair, decided to shed some take-off and landing slots at Paris's Orly airport, they were eagerly picked up by EasyJet, a low-cost British carrier. EasyJet saw them as a valuable bridgehead into the French domestic market.

The most extraordinary thing about the low-cost suppliers is not that their fares are so much lower than those of traditional “national carrier” airlines, but that their passengers are so much less discontented. In the difficult month of September 2001, Southwest had one complaint for every 263,000 passengers, less than one-sixth the level received by big airlines such as Delta, American and Northwest.

Some of that, of course, has to do with expectations. Passengers do not expect impeccable service on a low-cost airline, so they do not complain when it is not forthcoming. They also uncomplainingly put up with less well-appointed, less accessible airports where the landing fees are lower. Southwest, for example, uses Midway in Chicago, not O'Hare, and Love Field in Dallas, not Dallas/Fort Worth. EasyJet and Ryanair fly from Stansted, 40 miles (64km) from central London, not the more convenient Heathrow. Customers are happy if they get value for money. But like investors, they dislike being promised one thing and given another.

The family effect

In general, small businesses are more vulnerable to recession than bigger ones. This is partly because they tend to be more highly geared, and to have a less clear view of their competitive position vis-à-vis their rivals. This makes it harder for them to seize the opportunities that present themselves in a recession.

But there is one kind of small business to which this generalisation does not apply. “The special strengths of family firms help tremendously in time of recession,” says Peter Leach, a partner at BDO Stoy Hayward, a firm of accountants, and author of “Guide to the Family Business” (Kogan Page, 1999). These special strengths include their essentially conservative nature, their longer time horizons, and their lower appetite for gearing. Family firms do particularly well in cash-rich businesses that minimise the need for visits to the bank.

Traditionally, a big source of strength for the German economy has been its *Mittelstand*, the 3m or so family-run firms that make up the backbone of German business. But these companies have recently been finding it harder to raise loans and to persuade the next generation to succeed. This has raised fears that the German economy itself will become more volatile.

Mr Leach makes the distinction between the entrepreneurial type of small firm, where the owner drives around in a Rolls-Royce and smokes fat cigars, and the small family firm, where the owner is more likely to drive an old Ford and to take the cash generated by the business to the bank himself. There is some evidence to show that the values represented by the second sort pay off in the longer term.

BDO Stoy Hayward used to run a quarterly survey of what it called “the family effect”: the extent to which companies where a family holds a large block of shares outperform firms without any big family holdings. They found that the family effect in Britain in 1970-90 amounted to some 30%. Mr Leach reckons that if the survey were still being compiled today, the gap in Britain would turn out to be even larger. Similar studies in America over the same period came up with a family effect of over 80%.

Admittedly, many of the family firms that demonstrated this superior performance are not exactly tiddlers. In Britain, they include household names such as Cadbury Schweppes and Pearson; in America, they take in giants such as Ford and Hewlett-Packard.

Significantly, in both these American examples the families came to the fore again as the current recession started to grip. Bill Ford, a grandson of the company's founder, took over as chief executive from the more entrepreneurial Jacques Nasser in November. Walter Hewlett and David Packard, sons of the joint founders of Hewlett-Packard, raised objections to the plan of Carly Fiorina, the company's chief executive, to merge with Compaq. In both instances, the intervention looked like an attempt to restore some of the “family values” that seemed to have got lost in the go-go years of the late 1990s.

In the typical family firm, progress is measured in small, regular steps. This was not something the dotcoms wanted to build into their business models. They preferred to listen to gurus such as Gary Hamel, a fellow at Harvard, who argued in “Leading the Revolution” (Harvard Business School Press, 2000) that the world had entered a new business age, the age of revolution, in which incremental progress condemns companies to slow and certain death. Only revolutions, he felt sure, could hope to sustain organisations in the future.

The idea, born of the late-1990s boom, is not without its appeal. It requires companies to be led by “visionaries” in place of today's “administrators”, a lowly breed who Mr Hamel says “possess an exaggerated confidence in great execution, believing this is all you need to succeed in a discontinuous world. They are accountants, not seers.” Contempt for accountants is a widely shared sentiment these days. In Mr Hamel's brave new world, there is no room for planners either—which might not matter had Mr Hamel not been one of the most influential strategy gurus of the 1990s, who had been largely responsible for developing the idea of core competences.

And yet there are plenty of frugal companies that seem to have done extraordinarily well on a diet of careful planning, incremental improvements and, perhaps more surprisingly, being run from rather ordinary places. Warren Buffett's Berkshire Hathaway is based in Omaha, Nebraska, and Mr Buffett (sometimes called “the Oracle of Omaha”) is said to live in a house that he bought in 1958 for $35,000. Wal-Mart is based in Bentonville, Arkansas, a small town in a state with fewer people than the city of Atlanta. “There are no signs of opulence or ego at the company's austere headquarters,” wrote *The Economist* in December last year (see article). In a company whose current market capitalisation exceeds $250 billion, managers take out their own rubbish and pay for their own coffee. A decade after the death of Sam Walton, Wal-Mart's founder, his frugal philosophy still dominates the corporate culture. “Every time Wal-Mart spends one dollar foolishly,” he once wrote, “it comes out of our customers' pockets.”

Emerson has its modest headquarters just outside St Louis, and 3M, which regularly appears close to the top of lists of the world's most admired companies, is based in Minnesota. Harley-Davidson, whose motorbikes are sitting in the garages of some of the world's richest men, is based in Milwaukee, Wisconsin. Despite the cult status of its products, the company is every bit as averse to revolution as its workaday neighbours. And it has now vroomed its way through two recessions in a row. In 1991, its sales grew by 9% and its earnings fell by 3%. In 2001, sales grew by 16%, earnings by 26%, and the share price rose by 37% even as the S&P 500 index fell by 13%.

All of these last three companies are run by engineers, and much has been written about the parallels between engineering and management. Many of the best-managed companies in recent memory have been run by engineers (for example, Jack Welch at General Electric and Percy Barnevik at ABB), and management stars from F.W. Taylor to Tom Peters were trained as engineers before they took up other interests. Can their success have something to do with their respect for measurement and their natural abhorrence of waste?

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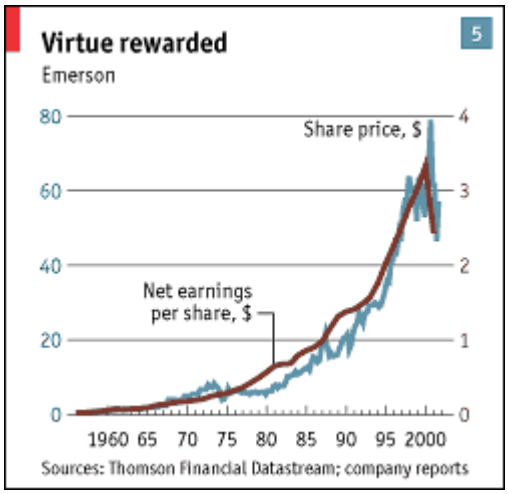
The spirit of St Louis

Mar 7th 2002
From The Economist print edition

Hidden away in Missouri is a company that truly believes in planning



WHEN America's Secretary of State for Defence, Donald Rumsfeld, heard that Britain's prime minister, Tony Blair, viewed the fall of Kandahar as the end of the war against the Taliban and al Qaeda, he retorted: “I'm from Missouri on this one.” Missouri's motto is “Show me”. Its people want to see results, and so did Mr Rumsfeld.

The same philosophy is shared by Emerson, a $15.5 billion electrical and electronics company whose unassuming headquarters sit just outside St Louis, Missouri's largest city. Emerson makes a wide range of goods, from household waste-disposal units to sophisticated compressors for air-conditioning systems. For 43 years in succession it reported an increase in its earnings, a record unmatched by any company quoted on an American stock exchange. But last October, Dave Farr, who had taken over as chief executive only a year earlier, had to announce the first year-on-year fall in the company's profits since the 1950s.

The decision could have been postponed, perhaps indefinitely, by some adroit accounting for the restructuring costs incurred in recent years as the company switched from electrics to electronics. But Mr Farr decided to come clean, in a webcast that could be seen simultaneously by the company's 124,000 employees around the world. “It was a very challenging communication,” he says modestly. The workforce was surprised that the news was not worse.

Like Jeffrey Immelt at GE, Mr Farr has taken on one of the most difficult tasks in business: to follow in the footsteps of a legend. His predecessor, Charles “Chuck” Knight, presided over the previous 27 years of successive earnings growth, and remains chairman of the company. During his reign, Emerson became a role model at business schools from Harvard to Stanford. Mr Knight's prize-winning article in the *Harvard Business Review* in 1992 remains one of the most illuminating ever written about the internal workings of a corporation.

In that article he wrote: “What makes us tick at Emerson is an effective management process.” The essential elements of that process are still drilled into every manager. They include a strong commitment to planning; a well-functioning system of control and follow-up; an insistence on being the lowest-cost producer in each business area; a determination to “keep things simple”; and a desire (in true Missouri style) for action and results. Mr Knight believes that companies don't fail because their analysis is faulty. “Management usually knows what to do,” he says, “but for some reason it doesn't do it.”

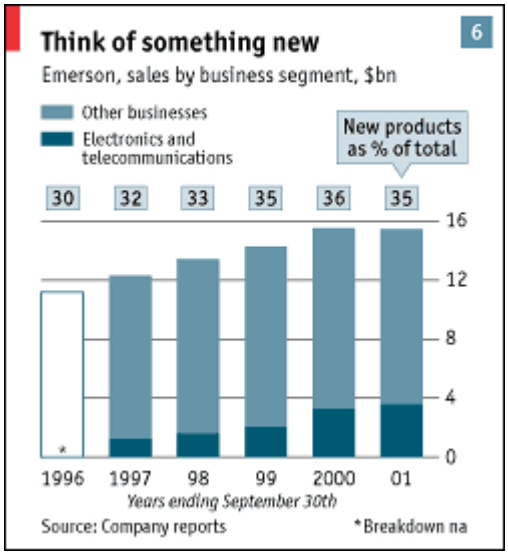
At the heart of Emerson's long-lasting success lies its planning process. Other companies come on pilgrimages to see it in action, but few manage to emulate it. Mr Knight spent up to 60% of his time in planning meetings of one sort or another, and Mr Farr does much the same. This is in sharp contrast to the average American corporate chief executive whose diary is full of pre-arranged meetings with outsiders that have little to do with their company's core business.

The planning process begins with the company's key managers, the heads of approximately 65 divisions. They present their plans for the future in small meetings at which the chief executive

continually challenges their assumptions. “One of the most powerful tools a senior manager has is a question”, says Boston Consulting Group's Mr Young. At Emerson, that tool is used to ensure that the divisions' plans are built on deeply conservative assumptions about growth and pricing.

Next, the pressure on managers to improve margins is directed at reducing costs. Material costs at Emerson have fallen in each of the past seven years. Having established such practice when things were going well has meant it was already second nature when the downturn came.

Emerson's system of control and follow-up depends on having accurate measurements of various aspects of its business. The engineers who run the company take it for granted that: “You can't control what you can't measure.” There is a small number of key business ratios that Emerson follows closely year in, year out—in particular, free cash-flow and its own measure of return on capital.



Like 3M, it also keeps a careful eye on the share of its sales coming from new products. In 1997, the company decided it was in too many old-established businesses with few new ideas, so it set out to reinvent itself. “We took some time off for self-assessment,” says one senior executive, “to search for new areas of growth”. Over the next three years, Emerson sold some electric businesses and bought some electronics ones, and decided that: “The future is Asia.” Its electronics business, which in 1999 accounted for 14% of sales, now makes up 22% and is set to increase to one-third. And the ratio of total sales that come from new products has risen from 30% in 1996 to 35% today. The company is showing Missouri, and the world, what it takes to bounce back.

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The return of von Clausewitz

Mar 7th 2002
From The Economist print edition

The fine art of being prepared

Hulton Getty

Prussian role model

PREPARATION is an art, not a science, which makes planning for the future of a business more complicated. Strategic business planning went out of favour in the 1980s and 1990s because it got bogged down in the mathematics of detailed business plans that might or might not be implemented. Jack Welch, the leader of leaders during that period, set the tone by shutting General Electric's 200-strong planning department in 1983.

But what he was getting rid of was strategic planners, not strategic planning. In his first address to Wall Street analysts as chief executive of the company in New York in December 1981, Mr Welch quoted extensively from a letter written by a senior manager to *Fortune* magazine which, as he put it, "captures, in words I find difficult to improve on, much of my own thinking about strategic planning for a company like General Electric".

Mr Welch's brand of strategic planning triumphed through the booms and busts of the following 20 years, until his retirement last year, so it is worth quoting the letter at length. It starts with a reference to Carl von Clausewitz, a great Prussian military strategist, and his most famous book, "On War", first published in 1832:

> Von Clausewitz summed up what it had all been about in his classic 'On War'. Men could not reduce strategy to a formula. Detailed planning necessarily failed, due to the inevitable frictions encountered: chance events, imperfections in execution, and the independent will of the opposition. Instead, the human elements were paramount: leadership, morale, and the almost instinctive savvy of the best generals.
>
> The Prussian general staff, under the elder von Moltke, perfected these concepts in practice. They did not expect a plan of operations to survive beyond the first contact with the enemy. They set only the broadest of objectives and emphasised seizing unforeseen opportunities as they arose. Strategy was not a lengthy action plan. It was the evolution of a central idea through continually changing circumstances.

In recent years von Clausewitz and other military strategists, such as the ancient Chinese sage Sun Tzu (whose "Art of War" first appeared on the shelves 2,500 years ago), have fallen out of favour as founts of wisdom for top managers. The new metaphor, pushed by Mr Welch as much as anyone, is sport, not war. Business bosses now lead teams, not troops, and reading Tiger Woods is considered more inspirational than perusing the dense prose of a long-dead Prussian.

But von Clausewitz is overdue for a comeback. A book published last year ("Clausewitz on Strategy", John Wiley) attempts to distil the wisdom and logic of "On War" and to rescue its author from the reputation of being "a cold and callous prophet of total, unconditional war". Somewhat unexpectedly, it has been put together by the Boston Consulting Group, which refreshingly admits that the "book is abstract and short on concrete advice."

The search for a single strategy that can solve all the problems of a business is gradually being called off. Sun Tzu, all that time ago, emphasised the importance of flexibility, speed and timing in the successful pursuit of war. Only that way, he said, could unforeseen (and unforeseeable) opportunities be seized as and when they arose. The secret was not to have a specific plan to be put into action, but to be prepared to put almost any plan into action, depending on the circumstances.

Good preparation during a recession involves, first and foremost, hanging on to the baby even as you

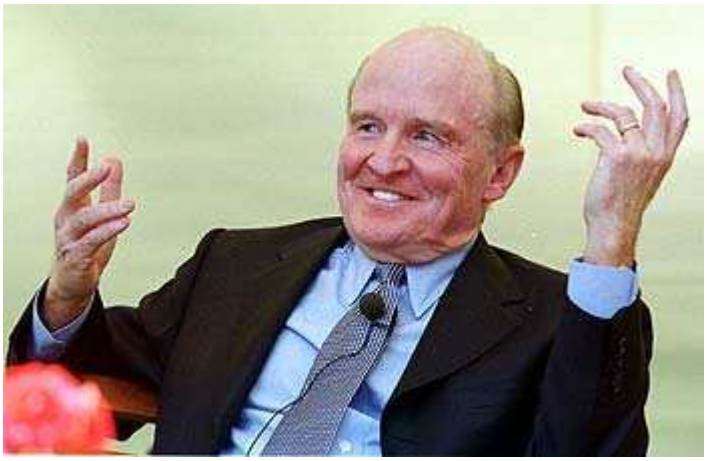
throw out the bathwater. This is to avoid what Al Suter, Emerson's former chief administrative officer, describes as “the danger that you're downsized out of the race”.

Spend as you cut

In 1998 Renault sent Carlos Ghosn to recession-struck Japan to turn around the French car maker's ailing affiliate, Nissan. Known in France as “Le Cost Killer”, Mr Ghosn began by hacking at the payroll and closing five factories. But even as he was making these cuts, he hired some expensive new designers from America and ordered them to produce no fewer than 22 new models before the end of 2002.

Jürgen Bartels, a German hotelier who took over the Méridien hotel chain in 2000, spent $1.2 billion refurbishing his properties in 2001, at a time when they were sitting half-empty anyway, so he did not have to turn customers away. Likewise, Accor kept spending on its IT programme last year, which it reckons helped it improve its operating margins despite the tourist slump.

When Mr Welch took over at General Electric, he was criticised for his decision to spend over $25m on building a new guesthouse and conference centre at the company's headquarters at Crotonville in the state of New York. At the same time, he was removing one employee in four from GE's payroll, in a downsizing exercise that earned him the label “Neutron Jack”. It has stuck with him ever since.



The softer side of Neutron Jack

In his autobiography “Jack” (Warner Books, 2001), he explains what he was trying to do: “The traditionalists were shocked. I persevered because I wanted to create a first-rate informal family atmosphere and needed this ambience to get it.” Crotonville was Mr Welch's “baby”, a point underlined in a later chapter in the book, “Remaking Crotonville to Remake GE”. He wanted a place with the right atmosphere where he could instil values that would be spread around the whole organisation. That was the central platform to his strategy.

For many companies today, their biggest “baby” is their key employees. The chief worry is that such people will leave in the general disenchantment of recession. Jorma Ollila, the chief executive of Nokia, a Finnish mobile-phone company, made headlines at the end of last year when he urged Finland's government to bring down the country's high income-tax rates within five years. He is worried about their effect on Nokia's ability to recruit and retain crucial R&D staff. Over 60% of these are currently based in Finland, a country with a population of only 5m.

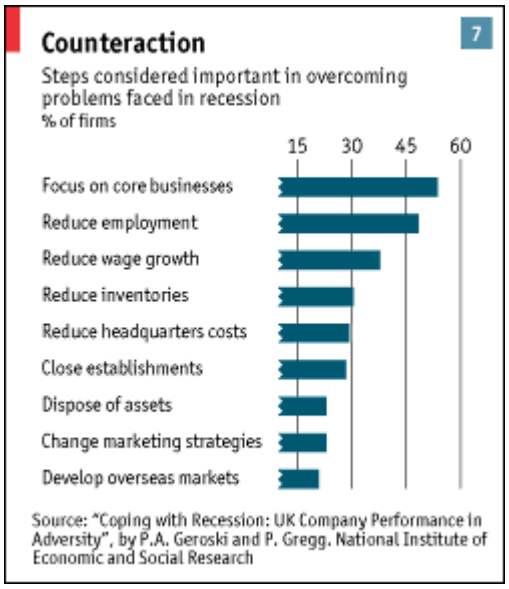
McKinsey's Beth Axelrod argues that even in a recession, companies should “keep the recruitment pipeline open... there is a lot of talent on the market right now.” Banks such as UBS Warburg, for example, kept on hiring last year even as they were firing. In past recessions, human-resources departments have been particularly vulnerable to staff cuts, but this time recruitment consultants have noted an upturn in the demand for top-level human-resources managers.

To hold on to their talent, companies have to be careful not to axe the things that such people value. Training is one example. A skilled marketing manager in her 20s, working for a large company in London, decided recently to leave because during three years with the company she was not offered a single day's training.

Cary Cooper, a professor at the Manchester School of Management, says that companies “need to re-establish the psychological contract between employer and employee”, a contract that has been eroded by the downsizing of the early 1990s and by the changed attitudes of younger employees to what is fashionably called the “work-life balance”. Many companies say that today's youth seems fickle and indifferent to building a career. Younger people do change jobs more frequently than their parents did at the same age, but according to Beth Axelrod this is just “a higher flow-through model” to which companies must adjust.

One thing that employers have learnt from this recession is that stock options are rarely an effective way of inducing loyalty. The “glue” for the younger generation is much more likely to come from the culture of the organisation and the career opportunities it offers them. Many were attracted to the crazier dotcoms as much by their informal working culture as by their stock options. Organisations such as Starbucks and Cisco Systems that create both a hip culture and (sometimes) profits are among today's best value-creators.

Paul Geroski of LBS found that, in Britain's recession of the early 1990s, companies cited “focusing on their core business” as being “important” more often than anything else (see chart). In bad times, firms are inclined to hunker down with the businesses they think they are best at, and to shed the rest. Bain's Mr Rigby says that companies which successfully navigate recessions “place a big bet on their core business and spend to gain market share”.



Core values

But are they right in doing so? In an article in the *Wall Street Journal* in April last year Chris Zook, a colleague of Mr Rigby's at Bain, drew a comparison between Amazon, a diversified Internet retailer, and American Express, a company that had stuck to its core business of providing financial services. It was clear which approach Mr Zook preferred: “Like so many of the businesses now experiencing troubles after the long boom, Amazon tried to diversify too far and too fast.” But by the end of the year that judgment was beginning to look questionable. In the fourth quarter of 2001, Amazon announced its first ever real profit, whereas American Express's earnings for the same period were over 50% down on a year earlier.

Some diversification can undoubtedly help when the going gets rough. Accor found that its luxury hotel brand, Sofitel, was hit hard by the recession, but its more down-to-earth chains (such as Ibis and Red Roof Inns, which rely heavily on domestic car-bound travellers) counterbalanced that effect. Accor's finance director, Benjamin Cohen, says this balance of risks gave the company an advantage over its competitors in the downturn.

The choice between specialisation or diversification may be more complicated than it appears. Take Nokia, the most talked-about success story to emerge from the recession of the early 1990s. At the end of the 1980s, Nokia was a medium-sized diversified conglomerate making cables, rubber boots and toilet paper; today it is a highly specialised mobile-phone manufacturer and one of the world's most admired companies. So specialisation wins hands down? Not necessarily: an earlier attempt by Nokia to become much more tightly focused proved to be a disaster. In 1987 it set out on a huge buying spree among TV manufacturers, aiming for scale in a mature market; yet less than ten years later it had got rid of all its consumer-electronics interests. The ill-fated venture had cost the company over $1 billion.

One lesson that Nokia learnt from this painful experience was to be wary of acquisitions. Almost all its growth in the mobile-phone business has been organic. The other lesson was to avoid becoming too dependent on any one market (in this instance, Russia). Its venture into mobile phones set out to be global from the start.

The Bain survey of large American companies in downturns during the 1980s and 1990s found that market leaders were better placed than their lesser-known rivals to thrive and survive in a recession. This vindicates the strategy, followed most famously by Mr Welch at General Electric (but by others too, including Emerson), to aim for the number one or two slot in each business sector or not to be there at all.

When recession comes, market leaders stay above water longer. They tend to have higher returns and can use keen pricing and marketing to get even further ahead of their rivals. This usually involves a brave decision to slice margins at a time when they are already under pressure.

GM's interest-free finance offers came only a week after the September 11th terrorist attacks. The car maker's boss, Rick Wagoner, had the confidence to make the move because he felt sure he had more cash and a better portfolio of products than his competitors. The result was impressive. GM's revenues in the fourth quarter were 2.1% higher than in the ebullient period a year earlier. Its profits for the quarter were 58% down on a year earlier, but they still amounted to $255m—and the company gained market share.

Dell Computer, the undisputed market leader in PCs, with sales equal to the combined total of the third- and fourth-largest companies in the sector, followed a similar strategy in 2001, with some success. In the final quarter of the year, when sales of PCs in America fell by 10-11% year-on-year, Dell was the only big firm in the sector to increase its sales and its market share.

Likewise, Wal-Mart used its market dominance to attack its ailing rival Kmart with deep price cuts. As a result, Kmart's same-store sales fell by 1% in December 2001 whereas Wal-Mart's rose by 8%. In January this year, Kmart filed for chapter 11 protection from its creditors.

This is what Boston Consulting's Stuart Grief calls “finding ways to outrun the bear”. Two hunters are being pursued by a bear; one stops to change into his running shoes. The other tells him he is crazy: there is no way he can run faster than a bear. “I don't have to run faster than a bear,” replies the first. “I only have to run faster than you.”

Those who outrun the bear of recession often go on to buy struggling rivals. According to Bain's Mr Rigby, “Clear winners in a downturn don't lock their purses; they spend on bargain acquisitions.” When asked, senior managers generally agree that recessions are a great time to go shopping, but they do little about it. Boston Consulting's Mr Nicol says very few firms are currently seizing the chance to acquire new businesses.

Some of the worst-hit industries are still highly fragmented. In the hotel business, for example, there are excellent opportunities for managers to win their spurs—especially in Europe, where only 20-25% of all hotels belong to big chains, compared with about 70% in America. Mr Cohen of Accor thinks that some hotel chains will actually grow during the recession, if only because there is bound to be further consolidation.

Within the airline industry too, consolidation was already overdue when the recession struck. The bubble years of the late 1990s had merely postponed it. By last November, *Aviation Week* was reporting that although traffic had fallen deeper than ever before, there was “a ‘can-do' spirit [among airline managers], a confidence that the airlines will rebound, some carriers even looking for opportunities, in spite of it all.”

It is possible to argue that a big new management idea has emerged from each of America's recessions in recent decades. After the 1979 downturn, Tom Peters and Robert Waterman published their book “In Search of Excellence”, which maintained that outstanding performance could still be found in American industry. At the time, it fired the imagination of managers who had been told over and over again that excellence in manufacturing had become the exclusive preserve of the Japanese.

What's the big idea?

After the 1990-91 recession, the dominant new idea to emerge was re-engineering, a term made famous by Michael Hammer and James Champy. By redesigning a company's business processes, the two gurus argued, quantum leaps in productivity were made possible. But the idea became debased because many companies tried to boost productivity solely by reducing the number of people on the payroll (“downsizing”) rather than by improving the production process.

Mr Nicol says that top managers no longer seem as obsessed as they have been in recent years with finding “the great idea” that will lead to better results. But perhaps that is the big idea to come out of the current downturn: that good management is not a matter of adopting short-term fads, but of managers being consistently honest, frugal and prepared over the longer term. That is what adds the most value for their shareholders—and for themselves.

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Offer to readers

Mar 7th 2002
From The Economist print edition

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Steel

Rust never sleeps

Mar 7th 2002 | NEW YORK, SEOUL, TOKYO AND WASHINGTON, DC
From The Economist print edition

President Bush's inflammatory trade sanctions will not save America's steel makers. Can they save themselves?

Get article background

AN AILING steel industry, a case of unfair trade before America's International Trade Commission and a president mulling sanctions. No, this is not 2002, but 1976, when Gerald Ford was in the White House and America's sickly steel companies were clamouring for import protection to help them back on their feet. Twenty-six years later, the same steel makers are still flat on their backs. The quotas, tariffs, subsidies and the like (worth well over $30 billion, according to some estimates) that America's politicians have lavished on steel companies in the interim have clearly taught policymakers nothing. Amid widespread groans, on March 5th President George Bush slapped tariffs, ranging from 8% to 30%, on an assortment of imported steel products for three years—a period of time, ventured Mr Bush's trade representative, Robert Zoellick, “that will give the US steel industry the opportunity to get back on its feet.”

The Europeans, in particular, are furious. More than a third of their $4 billion-worth of steel exports to America will be hit by a 30% tariff, and Europe's market may now be flooded with diverted steel. Some exporters, such as Brazil and Russia, in effect got more lenient treatment, making the European Union madder still. Pascal Lamy, the EU's top trade man, promised a swift complaint at the World Trade Organisation (WTO). Japan, another big producer, says it may join the Europeans. Consumer groups in America are in despair, as are most economists.

The EU has promised to safeguard its own markets from floods of foreign steel, and will seek compensation from America, as WTO rules allow. And although Mr Lamy publicly refuses to link the two cases, the EU may well act tougher in another fight about tax breaks for American exporters (where the WTO has declared America at fault). At best, the close transatlantic trade relationship has suffered a setback. At worst, Mr Bush has fired the first shot in a full-blown trade war.

Once again, America's steel industry has shown its extraordinary political clout. Against its 160,000 workers, Mr Bush had to weigh the interests of American consumers, foreign producers and, if his shrillest critics were to be believed, the future of free trade itself. And yet, in the end, the 30,000 steelworkers bussed into Washington for a last-minute “countdown to justice” rally had the final say. Leo Gerard, the president of the United Steel Workers of America, the union that organised the rally, said the tariffs offered the industry a “chance for survival”.

In the short term, he is right. Having fallen to below $200 late last year, the price of a tonne of hot-rolled steel has suddenly shot above $300, partly in anticipation of Mr Bush's three-year tariffs. That will help the 15 American steel makers operating under the protection of the bankruptcy courts (increased to 16 this week by the inclusion of Indiana-based National Steel). It will do nothing, however, to help restore the industry's overall long-term health.

Steel-company bosses say they need trade protection to upgrade their mills. But it costs several billion dollars to build a new “integrated” steel works, which makes the metal from iron ore. The capital markets, meanwhile, have been shut to the integrated producers, and with good reason: other companies can make steel more cheaply. Although the unions thunder on about unfair imports, most of

these low-cost rivals are to be found at home.

Take, for instance, the American operations of foreign steel makers, like those of South Korea's Posco, which is left wondering whether the tariffs will apply to the steel that it sends to its American joint venture for finishing off. Then there is LTV, an integrated steel maker that is about to emerge from bankrutpcy for the second time. Last month, LTV agreed to sell itself to W.L. Ross, a restructuring specialist. The deal is not yet done, as W.L. Ross must first negotiate a new contract with the union. But LTV's costs are sure to be lower than most other integrated producers'.

W.L. Ross will be relieved of LTV's “legacy costs”—the ruinous health-care and pension benefits that steel-industry bosses granted workers in the 1980s and 1990s in exchange for wage cuts. The effects of a big, new low-cost producer, says Wayne Atwell of Morgan Stanley, are bound to “ricochet through the industry”, repeating a cycle that he has observed many times.

An even lower-cost group of domestic producers are the mini-mill operators, such as Nucor, which make steel from scrap metal instead of iron ore. On average, according to World Steel Dynamics, a consultancy, the mini-mills use less than one-third of the labour that the integrated mills need to make a tonne of sheet steel. That makes them competitive with the Brazilians and South Koreans (see chart), while the integrated firms have the highest costs in the world.

The steel lobby claims foreign competition is killing the industry, but that is simply not true: American steel-making capacity is no lower now than it was when President Ford was contemplating sanctions. The headline figure, however, masks big changes in fortunes since 1976. The unionised, integrated producers have lost about half of their market share. The non-union mini-mills have grown fivefold, and now claim nearly half the market.

This process is sure to continue. On top of their lower labour costs, the mini-mills' electric-arc furnaces are much cheaper to build than iron-ore blast furnaces. Best of all, the mini-mills have a natural hedge against a downturn in steel prices, because the price of scrap steel, their input, rises and falls with their finished product. Apart from US Steel and AK Steel, the two biggest producers, every integrated steel maker that is not already in the bankruptcy courts is likely to end up there, with or without trade barriers. The market thinks Nucor, on the other hand, is worth more than all the integrated producers combined.

That does not mean that the old-line firms can do nothing. US Steel's recent proposal to merge with several bankrupt rivals hinged on Mr Bush picking up their legacy costs, which he has refused to do. But mergers are still possible if bankruptcy courts agree to scrap these obligations, as they did with LTV.

Also, companies could try to renegotiate their labour contracts with the steel union. As well as guaranteeing what is still a good hourly wage, these agreements stifle innovation (through detailed work rules) and offer health-care benefits that are far more generous than those which the steel firms' white-collar workers get.

The braver bosses could even try making different steels, or the same steels differently. AK Steel, one of the better integrated producers, has prospered under both approaches, innovating to reduce maintenance expenses and switching production to higher-margin steels. Last year, say company officials, its four biggest integrated rivals lost, on average, $57 per tonne of steel made. AK Steel, on the other hand, made operating profits of $21 per tonne.

Yet the suspicion is that such gambles lie beyond the talents of most steel managers, who have grown soft under the soothing influence of trade barriers and subsidies. LTV, for one, failed miserably to turn itself into a zippy mini-mill producer.

Now that steelworkers have won most of what they were demanding from Mr Bush, steel bosses are unlikely suddenly to find the strength to take on the union. Most depressing of all, even the mini-mill operators, led by Nucor, lobbied hard for trade barriers. If the modern, competitive producers succumb to protection and subsidies as well, American steel's future may look all too similar to its inglorious past.

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America's defence industry

Military intelligence

Mar 7th 2002 | LOS ANGELES
From The Economist print edition

Northrop Grumman sets its sights on TRW's high-tech jewels

Global Hawk: an expensive bird

THE use of information technology to gather military intelligence and to guide weapons to their targets pervades current military thinking in America and elsewhere. The fighting in Afghanistan has confirmed the effectiveness of sophisticated long-distance weapons and unmanned drones to spy on and attack enemies without exposing soldiers to undue risk. September 11th and its aftermath have also strengthened America's political commitment to missile defence.

All these trends confirm the wisdom of the strategy that Northrop Grumman, a defence contractor based in Los Angeles, has pursued for the past five years. On March 3rd the company made another strategic leap, launching a hostile takeover bid for TRW, a maker of satellites, communications equipment and powerful lasers based in Cleveland, Ohio. Kent Kresa, the Grumman boss who engineered the merger with Northrop in 1994, and who has led the firm since, saw the trend towards electronic warfare sooner than others in the industry.

Through a series of bold acquisitions he has taken the company from a distant fourth among defence contractors to a strong third, with revenues of $13.6 billion last year. At the same time as he has been buying electronic warfare assets, Mr Kresa has had no hesitation in selling off businesses he felt were no longer crucial, such as Northrop Grumman's aerostructures division. Among the fruits of the new strategy has been $800m-worth of contracts for Global Hawk, an unmanned aircraft that can stay aloft at 65,000 feet for 36 hours and scrutinise the ground, even through haze or darkness.

All that was missing from Northrop Grumman's high-tech quiver was missile-defence capability, and that is the attraction of TRW. Once Northrop has sold off TRW's car-parts division—which accounted for about 60% of last year's sales of $16.4 billion, but little of its profits—the jewels will remain: the electronics and the satellite, spacecraft and laser technology.

America has a budget of $38.7 billion for the research and development of missile defence between 2003 and 2007, and that is just the start of the bonanza for contractors. The final cost of the average Pentagon programme goes up by 30% over its lifetime, according to Theresa Hitchens, an analyst at the Centre for Defence Information, a think-tank in Washington, DC. That would push R&D spending close to $50 billion. And then comes production and deployment—an especially lucrative business if President George Bush's dream of having systems in space is to come true.

Still, before it can join Boeing and Lockheed Martin, the two largest defence contractors and the leaders in missile defence, Northrop Grumman will have to secure TRW, and so far the target is resisting. Northrop's first approach, a friendly offer of $5.9 billion, was rejected by TRW's board, so it has gone directly to the shareholders with an offer worth $47 a share. The market expects more than this: TRW's current share price is over $50.

Others may yet join the bidding, although competition worries are likely to keep both Boeing and Lockheed Martin from pitching in. Should it wish to fight off the bidders, TRW will be helped by Ohio's laws, which protect local firms against hostile takeovers.

Whatever TRW's fate, Northrop will be busy for a while digesting recent acquisitions. Last year it bought Litton Industries for $5.1 billion and Newport News Shipbuilding for $2.6 billion, raising its debt to $5

billion at the end of 2001, compared with $1.3 billion a year earlier. Integrating companies acquired in the bout of consolidation that gripped the industry in the mid-1990s has caused both Lockheed Martin and Raytheon, the fourth-biggest defence group, financial and strategic pain. Still, Mr Bush's administration is doing its best to make things more comfortable for the industry's voracious titans.

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Entertainment industry

The roar of greasepaint

Mar 7th 2002 | LOS ANGELES
From The Economist print edition

Actors are booing each other when they should be facing the world

HOLLYWOOD actors may seem cool and composed on screen, but off it they have lately been demonstrating spectacular incompetence. On March 8th the 98,500 members of the Screen Actors Guild, their union, will vote to elect a new president, despite having already elected Melissa Gilbert (who played Laura Ingalls Wilder in “Little House on the Prairie”, a television series, in the 1970s) as president in November. Her defeated rival, Valerie Harper (also a star of 1970s television, as “Rhoda”), complained that ballot irregularities in New York had skewed the result, and demanded a fresh vote.

She got her way. Despite the claims of Ms Gilbert's supporters that things in New York had always worked that way, the guild's election committee ordered new ballots to be sent out in January. Shortly afterwards the federal Department of Labour launched an investigation to see whether repeating the election was legal.

Neither the new election nor the investigation—which could invalidate it—will yield results for some weeks. Meanwhile, the guild's two factions are hurling vitriol at each other across fax lines and computer screens, and in the pages of Hollywood's trade papers. Entertaining though the bust-up is, however, it distracts the guild from tackling a number of more serious questions.

One challenge is adapting actors' contracts to evolving technology. In 2000 actors went on strike for six months over the issue of “residuals”: royalties paid when advertisements are reshown long after their original broadcast. As distribution methods such as cable and satellite television, DVD and the Internet proliferate, actors and film studios haggle more noisily over how to divide the spoils from new ways of selling entertainment.

Top of Hollywood's worries, however, is “runaway production”. In 1999, 13% of the films shot in North America were made in Canada; a year later, the share was 26%. Tax incentives, lower wages and the weak Canadian dollar all contribute to making production around 25% cheaper in Canada than in the United States, and many American film and television productions have headed north. Studies suggest that films and television shows shot in Canada could be costing the American economy around $10 billion a year. Other favourite locations for runaway productions include Britain, Ireland, Australia and the Czech Republic. The actors' guild and other Hollywood unions have called for tax breaks and protection.

One film at least has not run over the border. “Terminator 3”, with a budget of over $170m, will be shot entirely in Los Angeles, contrary to earlier plans. Actorly politics is at work here too. The film's star, Arnold Schwarzenegger, is considering running for governor of California in 2006. The Austrian-born former bodybuilder must have hinted delicately that it would not help his chances to export all those jobs.

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General Motors and Fiat

A duo of dunces

Mar 7th 2002 | GENEVA
From The Economist print edition

GM and Fiat make apt partners: both are bottom of the class, but trying

Get article background

AS THE bosses of Ford and General Motors (GM) flew in for the Geneva motor show this week, they received very different briefings from their managers in Europe. Bill Ford, chief executive of the company founded by his great-grandfather, heard how Ford Europe, which lost around $1 billion in 2000 and barely broke even in 2001, is expecting to make a profit this year. Meanwhile, GM's chief executive, Rick Wagoner, heard how GM Europe (whose main brands are Opel, Vauxhall and Saab) could only hope to halve its losses to $350m this year.

Worse, sharing the dunce's cap with GM for the biggest car-industry losses in Europe is Fiat, GM's partner in the region since the two took cross-shareholdings in each other nearly two years ago. Fiat Auto has just reported an operating loss of *euro*549m ($490m) for 2001. When GM took a 20% share in Fiat Auto, and Fiat got 6% of GM, they were keen to make savings through joint purchasing and by sharing engines and transmissions. But the benefits have been slow to emerge.

Both companies are now in the midst of frantic efforts to put things right. Last December, the boss of Fiat Auto lost his job as the company started to close or shrink 15 factories and cut 6,000 jobs. Fiat has pinned great hopes on its new mid-sized Stilo car. But the company is already rushing out cheaper low-specification versions of the Stilo to sell into the Italian fleet market—a sure sign that it is nervous about the new model's prospects.

Fiat's American partner is also swinging the axe and praying for success with a new model. The man with the toughest job in GM Europe is Carl-Peter Forster, chairman of its Adam Opel subsidiary since last April—and one of the handful of executives who left the top ranks of BMW after its debacle with Rover, a British car maker. He is certainly bringing fresh thinking to Opel: he sees his priority as “cutting our capacity to the number of cars we can sell”. Capacity is to come down from 3m units to around 2m, with the loss of 4,400 jobs in Belgium, Britain and Germany. This week GM also admitted for the first time that it has excess capacity, of about 1m units, in North America.

Opel's plants are also being adapted so that each one can make two models and switch production if one is selling better than the other. Mr Forster's ideal is to have two models at different stages in their life cycle sharing each plant. As the older model's sales fizzle, so the younger one can take up the slack. This echoes the strategy practised so skilfully by BMW, Volkswagen and Honda, and now being introduced by Ford.

Mr Forster also wants to spruce up Opel's dilapidated product range, to which he added a new Vectra this week. He is aiming for 10% of the European market for medium-sized cars. But this segment is being squeezed by fancy small cars and compact Multi-Purpose Vehicles (MPVs), so Opel is looking to expand the share of its overall sales that comes from MPVs and the like to 40%.

The connection between production and marketing is the boldest leg of Mr Forster's revival plan, grandly known as Project Olympia. Instead of building cars for stock, he is turning the production system on its head. The aim is to manufacture well over half the vehicles according to a specification already ordered by a customer, for delivery within three weeks. This sort of “build-to-order” (BTO) strategy has been used most often by upmarket brands such as BMW, but it is now catching the eye of volume car makers. Already, 70% of Opel's Zafira MPVs are built on a BTO basis. Mr Forster is confident that he can extend this to other models, making huge savings in inventory costs along the way. For GM to be doing this is revolutionary. That is just as well, because nothing short of a revolution can rescue Opel.

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Franco-German alliances

Rhine or shine

Mar 7th 2002 | FRANKFURT
From The Economist print edition

For every happy Aventis there is a miserable MobilCom

CONVENTIONAL wisdom has it that friendship between French and German politicians is the cornerstone of the European Union. Business, though, is another matter. In the era of the single currency and single market, successful tie-ups across the Rhine are still a rarity.

Hats off, then, to Aventis, the product of a merger in 1999 between Hoechst, a German drugs and chemicals group, and Rhône-Poulenc, a French rival. The merger, the first cross-border marriage of two big European companies of roughly equal size, was messy, with a pong of political compromise. The head office was put in Strasbourg, on the border but in France, while top jobs and plant cutbacks were shared between the two nations. Yet this week, when Jürgen Dormann, who ran Hoechst before taking the top job at Aventis, said he would quit the management board, he could look back on a job well done. Having narrowed its focus to pharmaceuticals, Aventis recorded results for 2001 that put many rivals to shame.

Not that Franco-German co-operation always work so well. For the past three weeks or so, France Telecom, a giant more than 50% owned by the French state, has been trading insults with MobilCom, a German company in which the French carrier has a 28.5% stake and which has won one of Germany's six third-generation (3G) mobile-phone licences. French efforts to conquer the German market using MobilCom appear to be in tatters.

According to MobilCom's founder and biggest shareholder, Gerhard Schmid, France Telecom is obliged to fork out up to *euro*10 billion ($8.7 billion) by 2010 to help build MobilCom's network. Oh no we aren't, say the French: we have to approve your business plan first, and we haven't. France Telecom also wants an explanation of another plan of MobilCom's: to reward its dealers with share options using shares supplied, for a fee, by a company controlled by Mr Schmid's wife. MobilCom, which insists all is above board, brought in a special auditor on March 6th.

It is harder to reach a verdict on the grandest Franco-German venture so far: EADS, an aerospace and defence company of which Germany's DaimlerChrysler owns 30% and the French government and Lagardère, a French company, 15% each (there is also a small Spanish stake and a free float). There are two chief executives (one French, one German) and two headquarters (one in Paris, one in Munich). There have been stories of turmoil between the French and German sides. That said, EADS's biggest asset is a majority stake in Airbus, an aircraft maker which is now giving Boeing a run for its money.

It could be that the success or failure of Franco-German link-ups depends less on nationality than on markets and individuals. Aventis not only managed its merger well; it has three blockbuster drugs, and has grown fast in North America, which now accounts for almost 40% of its sales. The telecoms tiff stems largely from the ludicrous prices paid for German 3G licences. Mr Schmid, a stocky qualified ice-hockey coach, and France Telecom's Michel Bon, an elegant product of the French civil service, seem unlikely soulmates.

EADS's structure largely reflects the preferences of its customers in defence ministries, who still like to buy from national suppliers. A European single market ought to mean more attempts at cross-border alliances and mergers. Chances are, few will turn out as happy as Aventis.

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Japan's post office and gangsters

Handle with care

Mar 7th 2002 | TOKYO
From The Economist print edition

It isn't only dogs that intimidate postmen

AS THIS week's continued ructions at Britain's Consignia show, post offices around the world are struggling to turn themselves into modern, well-managed, profitable companies. But of all the problems that they face, few can be as bizarre as the one with which Japan's postal agency is currently grappling: gangsters who want their mail treated with special care.

An embarrassed postal operator has admitted that 344 post offices, including 50 in Tokyo, have for years been giving special treatment to mail sent to or from folk in Japan's powerful crime syndicates. Gangsters had been upset when envelopes turned up scuffed, dirty or late. Consequently, their mail, marked “handle with care” or “violent” (the character for “violent” is also the first character in the word for gangster organisation), was placed in special bags, given kid-glove treatment and, in some cases, expedited.

The authorities are now cracking down on the practice. To help nervous postal workers say no, post-office managers will be sent on courses run by local public-safety commissions on how to resist intimidation from goons. The postal agency will also set up fresh guidelines of its own and improve contacts with the police.

The post office, which will be turned into an “independent” public company next year (and might even be privatised after that if Junichiro Koizumi, the prime minister, has his way), is also Japan's biggest financial institution. It controls more than a third of the savings and life-insurance markets. This latest discovery may have left depositors and policyholders wondering what other perks Japan's gangsters enjoy.

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Hewlett-Packard and Compaq

Planning to prove them wrong

Mar 7th 2002 | SAN FRANCISCO
From The Economist print edition

Many corporate marriages fail because they are poorly executed—a mistake Hewlett-Packard and Compaq are striving to avoid

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Reuters

Focused Fiorina

IF SHAREHOLDERS reject the $22.8 billion merger of computer makers Hewlett-Packard (HP) and Compaq, it is highly unlikely that Carly Fiorina will stay on as HP's chief executive. Yet she has been in a remarkably good mood lately—even quipping late last week about the wisdom of choosing April Fool's Day as the date on which to launch the new company.

Ms Fiorina must have had more than an inkling of what was to come. On March 5th Institutional Shareholder Services (ISS), an influential proxy advisory firm, recommended that its customers cast their ballot in favour of the proposed merger, on which shareholders will vote on March 19th. This endorsement turns the momentum in favour of the deal, which seemed all but dead when Walter Hewlett, son of one of HP's co-founders and a member of the company's board, started a proxy fight in November. In addition, on March 6th the Federal Trade Commission unanimously approved the merger without attaching any conditions to its decision.

With the odds for success increasing, the strongest argument against the merger—namely, that it will fail to deliver the promised cost savings and hurt revenues because of bad execution—is back in the spotlight. One thing is clear: HP and Compaq hope to lower this risk by planning the integration down to the smallest detail. This task is already well under way.

“Half a million man-hours of work have thus far been devoted to integration planning, which surely makes HP-Compaq one of the most exhaustively planned combinations ever,” writes ISS in its report. This focus on planning is the result of some hard lessons. Lack of planning was the main reason why the merger of Compaq and Digital Equipment Corporation failed to pay off, at least initially. In fact, of the American companies that merged in 1997 and 1998, about two-thirds cited bad planning and execution as important reasons why their unions failed to live up to expectations, according to a recent study by Booz, Allen and Hamilton, a management consultancy.

With such findings in mind, says Ms Fiorina, both boards began discussing how to put their firms together “even before we called the bankers”. One of the first decisions was to name the executives who would head the business units of the merged company so that they could be involved in the planning. In contrast, the integration process for Compaq and Digital started late and was leaderless for a long time.

HP and Compaq were also quick to create an integration office, known internally as the “clean team” because it has to remain segregated from other employees as long as the two companies are rivals. This group, which now has around 600 full-time members, is a kernel of the future company. Each of its four main business units has its own working group. Other teams deal with general issues, such as IT systems, finance and human resources. Yet more people are working on fuzzier issues, such as “value capture”—consultantese for making sure that the merger yields the promised annual cost savings of $2.5 billion by 2004.

Invent, don't reinvent

All these groups were given clear principles for how to proceed. One such is something called “adopt and go”. Working groups evaluate the two firms' approach to a given problem and pick the better, instead of trying to create something new. Reinventing the wheel would be disastrous, argues Webb McKinney, president of HP's business-customer unit and co-head of the integration team with Jeff Clarke, Compaq's chief financial officer.

Making decisions quickly and sticking to them is crucial, says Mr McKinney. If the working groups cannot agree, consultants are called in to help adjudicate. Difficult decisions, such as the organisation of the supply chain, are moved up to a “steering committee”, which meets every Thursday for half a day and is composed of the two companies' top brass.

The Internet is also helping to speed things up. The working groups make much use of collaboration tools, such as online calendars and spreadsheets. The blueprint for the future company exists not on paper but in a secure website operated by eRoom, a start-up based in Cambridge, Massachusetts. The members of the integration team have already created 2,600 folders with 10,000 files.

Yet technology is not much help in sorting out the cultural issues. Here the two firms' response has been “cultural due diligence”. As part of this pretentiously named process, human-resources staff have interviewed 150 senior executives and arranged 35 focus groups for employees. And what have these discovered? The two firms are not that distinct culturally, says Susan Bowick, HP's head of human resources, particularly if one compares divisions that operate in the same markets.

But there are differences. HP employees prefer voice mail, while Compaqers rely more on e-mail—which led to some initial communication problems between Messrs McKinney and Clarke. More importantly, HP grew up as a firm of engineers and tends to think long and hard before making a decision. In contrast, Compaq is still a PC maker at its core, and thus in the habit of making quick calls.

The integration team is now working out how to launch the new company if the deal closes in late March. Sales representatives will get information “tool kits” to help them explain product plans to customers. And the integration group will stay in place for at least a year to make sure its plan gets executed properly.

To be sure, all this may never happen. Sceptics still put the merger's chances at no better than 50-50. Mr Hewlett may yet get his way, even though ISS has now argued that his alternative proposal—the linchpin of which is to spin off the imaging and printing business in the near future—would create more uncertainty, in particular for HP's other businesses.

Win or lose, Mr Hewlett deserves credit for having raised tough questions. All too often, shareholders and board members sign off on management decisions without bothering to convince themselves. In this case, the opposition pushed the two companies to think harder about what exactly they hope to achieve—a consequence that even Ms Fiorina approves of. “Every cloud has a silver lining,” she says. “People are now incredibly focused on proving the opposition wrong.”

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About sponsorship

Face value

The poster-child who grew up

Mar 7th 2002
From The Economist print edition

Marc Andreessen's journey from Netscape to Loudcloud shows how much the Internet has changed

THE birth of the Internet boom can be dated precisely. It began on August 9th 1995, when Netscape, pioneer of the web browser, went public. Its share price more than doubled on the first day of trading; mania ensued. Marc Andreessen, the boyish, round-faced, 24-year-old programmer who had co-founded the firm in 1994, embodied the Internet dream. Within a matter of months, he had transformed a programming project at the University of Illinois into a multi-million-dollar company that challenged the world's software giants. Suddenly, anything seemed possible. A rush of other Internet firms launched their own share offerings. And the rest is history.

That is certainly how it feels today, at any rate. Netscape's dominance in web browsers prompted a vicious and ultimately victorious counter-attack from Microsoft. Netscape was forced to retreat, in November 1998, into the arms of AOL, the world's biggest Internet-access provider. Mr Andreessen stayed on at AOL for a few months. But in September 1999 he left, along with three other Netscape veterans. “We sat around for three weeks and said what do we want to do?” he says. Eventually the four founded a new company, Loudcloud, which is as different from their old firm as it is possible to imagine.

For a start, says Mr Andreessen, he did not want the new firm to be in the business of selling software to large companies. The trouble with selling software, he says, is that software vendors end up in an adversarial relationship with their customers. The customers know that the vendor needs to meet its quarterly sales target, and is often dependent on a few large sales to do so. The result is a frenzy of last-minute negotiation and price-cutting at the end of each quarter. An industry joke tells of the chief financial officer of a software firm who calls down to the loading bay on the last day of the quarter to ask how many units have shipped. “Too early to say,” comes the reply. “It's lunchtime, so we're only halfway through the quarter.”

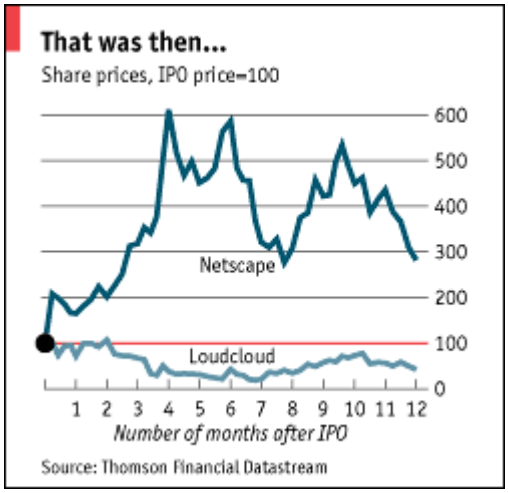
The situation at AOL is different. Because AOL is a service business, its revenues are predictable. Once a month, it collects $20 or so from the tens of millions of customers to whom it provides Internet access. Mr Andreessen decided that his new firm should also run on a service model.

Another decision, made early on, was that the new firm should not compete with Microsoft. “Everybody should be in a business once in their lives that competes with Microsoft, just for the experience,” says Mr Andreessen. But once, he decided, was enough.

He and his colleagues also noted that the infrastructure required to run a typical website had become extremely complicated since the early days. They decided that Loudcloud should concentrate on a particular niche: simplifying the management of Internet infrastructure. To this end, they developed some clever software, called Opsware, that centralises and automates the configuration of the various boxes that power websites: servers, routers, storage systems and so on.

Using this software, Loudcloud now operates websites for clients including Adidas, Ford, Nike, *USA Today*, News Corp and the British government. The outsourcing of website management

(known as “managed hosting”) saves these clients money, says Mr Andreessen, since they no longer have to deal with multiple suppliers or technologies. News Corp, he claims, has reduced the cost of running its sites by 60%. Another advantage of the Loudcloud model is that it allows new servers to be set up quickly, so that a website can handle more traffic. *USA Today*, for example, increased the capacity of its site threefold on September 11th as visitor numbers surged in the wake of the terrorist attacks.



Loudcloud went public exactly a year ago and raised $150m in a gloomy market. Mr Andreessen argues that a slump is a good time to build a business. There are no “me-too” imitators or “kamikaze competitors” burning money and resorting to silly tactics to gain market share, as there were during the dotcom boom. It is easier to retain employees when they are not always looking for a new job at a firm on the verge of going public. And, in contrast with Netscape's early days, there is no need to deal with the problems of “hypergrowth”. Instead, there is enough time to choose the right employees and to build a company culture. That eliminates the problem of rivalry between workers who have been taken on at different times and therefore have stock options with widely varying values. Loudcloud has steadily growing revenues and is on target to become profitable in 2003.

Sign of the times

In other words, Mr Andreessen does not regret the passing of the boom years. These days he wears a smart suit, rather than a denim shirt and jeans. He is a manager, not a keyboard jockey. He last wrote a line of code, he says, in 1994. The super-fast Mercedes and an impractical military vehicle that previously belonged to Arnold Schwarzenegger, a Hollywood star, are gone; he now drives a low-key sport-utility vehicle instead.

The Internet has changed, too, as Mr Andreessen's own journey from Netscape to Loudcloud illustrates. What was once the province of geeks is now ruled by suits. The web has become the basis of a vast and complex industry dominated by large companies. Even though it started as a consumer-led phenomenon, the Internet's greatest impact has been on business. There turned out to be very little money in selling “front-end” software such as browsers to consumers; but there were fortunes to be made at the “back-end” selling services, software, storage and hardware to companies. Loudcloud may be successful in its own way, but it will not be the Netscape of the decade, the dawn of a new world. The Internet, like its poster-boy, has grown up.

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European financial services

Scrapping over the pieces

Mar 7th 2002
From The Economist print edition

Laborious efforts towards a single market

PLANS for developing a single European market in financial services are years behind schedule. Regrettably, their realisation hangs on scant resources and laboriously detailed laws and compromises. From time to time the visionaries get together to give the whole tattered project a shove.

One shove comes from the European Union summit in Barcelona on March 15th-16th. Perhaps Germany will give some ground on a new draft EU law for cross-border takeovers—the last one was shelved last July in the face of German opposition, after 12 years of work. Behind the scenes, there is back-biting about the poor commitment of resources by some countries, notably Germany, and despair at the political deals that tend to block or sweep away months of careful negotiation.

There is disagreement, too, about the ultimate prize. Officially, it is to make Europe the most dynamic market in the world for raising and deploying capital—the competition being New York and Tokyo. Unofficially, it is a bargaining game between European financial centres—London, Frankfurt and Paris. Champions of a pan-European capital market, especially the big international banks based in London, are afraid that the British sense of fair-play, and Germany's preoccupation with other battles in Brussels, will allow the French to steal the prize. France's hidden agenda? A pan-European financial regulator based in Paris.

Beneath the conspiracy theories, there has nevertheless been notable progress in the last year. If it has failed to produce actual legislation, then at least (after some hiccups) it has improved the way that future legislation is discussed, drafted, enacted and enforced.

Take three EU directives at present undergoing intensive work: one on prospectuses (documents required to accompany the sale of new securities), one on market abuse (such as insider-dealing), and one on investment services. The first two were rushed out in draft form last year by the European Commission, without consultation, in an attempt to speed up the process. Howls of protest from practitioners, and even from some national regulators, complained that the proposals were half-baked, particularly concerning prospectuses. The drafters seemed to have forgotten that securities include debt as well as equity, and that debt is often issued outside the issuer's home country. The market-abuse directive did not take on board the way that investment banks address internal conflicts of interest—with Chinese walls, for instance—nor the sophistication of many investors who do not need costly protection from abuse.

The many objections to these two directives are being addressed in the only way possible, by scores of amendments by members of the European Parliament's committee on economic and monetary affairs. The amendments, finally passed in committee last week, will be voted on by the full parliament on March 13th, after which the European Commission is expected to negotiate each point—implying a virtual redrafting of at least the prospectus directive. But the commission has learned its lesson. The new investment-services directive is undergoing consultation—before it appears in official draft form.

Another small triumph was the European Parliament's agreement last month that two outside committees be allowed to fine-tune European securities legislation. This was the nub of a proposal a year ago by a group of “wise men”, chaired by a Belgian central banker, Alexandre Lamfalussy, to speed up the

creation of an EU-wide securities market by 2003.

So much for the wholesale markets. An integrated retail financial market is expected to take a little longer: until 2005. On February 22nd, a meeting to review the whole project (dubbed the Financial Services Action Plan) gave the private sector a chance to comment. There was concern that the collapse of Enron would prompt excessively tight regulation and would set European law-makers against the better features of the American model of deep, open markets.

The strongest message came in a report by some German economists that put a number on the opportunity cost of not integrating Europe's retail market for financial services: they claim an extra 0.5-0.7% growth in European GDP each year. Is that enough to spur Brussels to greater efforts?

It is partly a matter of resources. There are only about 100 people at the European Commission working on financial services. Perhaps one or two dozen are sufficiently qualified for the job, and they are overburdened with drafting, consultation, negotiation and enforcement. Understaffing is a problem for many ministries and regulators, and it is a serious obstacle to building the single market. Counterparts complain that the German ministry too often sends to Brussels just “a man and a boy”.

Enforcement will be the real challenge, assuming that all the cumbersome legislation goes forward—on financial conglomerates, pensions, new capital-adequacy rules, risk capital for small businesses, clearing and settlement, accounting standards and insolvency rules. Then comes the takeover directive, without which, says Mr Lamfalussy, “we will not have a single European market.”

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About sponsorship

Downtown Manhattan

As you were

Mar 7th 2002 | NEW YORK
From The Economist print edition

Can life on Wall Street return to something approaching normal?

AP

A bargain near Ground Zero

BEFORE the attacks of September 11th, Century 21 was a discount store in a shoddy old bank building in downtown Manhattan, famous for its lively disorder, its unhelpful staff and for the bargains galore on its chaotic racks. It somehow captured the essence of Wall Street, and was greatly loved. On February 28th, the store reopened. The crowds that have since pushed through its doors are being seen as a sign that something like life as it was lived on September 10th is returning to New York. There is even talk of a bull market (see article).

The long succession of funerals and memorials that filled every church and temple in Manhattan is over. Still, things are not back to what they were, by a long chalk. On their way to a view of what remains of the World Trade Centre, tourists file past a wall covered with children's drawings of the attacks. A nursery school affiliated to old Trinity Church by Wall Street will soon return to its former home, yet a third of the parents have pulled their children out, because they, or their jobs, have moved away. George's Lunch, just across from the church, lost many customers in the World Trade Centre. Now, the New York Stock Exchange is wrapped in security, and George's is unable to deliver meals that once were ordered in.

Slowly, some of the worst-hit companies are returning to lower Manhattan. Merrill Lynch has moved back into the World Financial Centre, with American Express coming back soon. Others are starting again elsewhere. Lehman Brothers, whose headquarters in the American Express building saw heavy damage, has brought together most of its 40-odd temporary locations into a midtown tower that was just being finished for Morgan Stanley. Morgan Stanley, in turn, will move some of its operations to Texaco's old headquarters in Westchester, a New York suburb. Goldman Sachs, another downtown firm, says it intends to move some crucial operations across the Hudson river, to Jersey City.

Morale is still vulnerable. Firms that promise to pay bonuses are postponing them, in order to delay accounting for them until the next financial year. At many firms, of course, bonuses are out of the question. At Merrill and at CSFB, new chiefs put the emphasis on reducing staff. More quietly, Goldman Sachs is also cutting, intending to get rid of perhaps 2,000 employees, one-tenth of the workforce worldwide.

Though bargain-hunters are out, in the stockmarket as well at Century 21, Wall Street firms still find it tough. The profitable business of public offerings is dead, and advisory business is weak. The market for raising debt is strong, but investment banks do not earn a great deal of money from it, particularly since interest rates are unlikely to fall (and bond prices rise) as they did last year. Trading volumes are strong enough on the New York Stock Exchange, which this week said it had held preliminary talks to take over its smaller rival, The American Stock Exchange. But volumes are weak on Nasdaq, where more money can be made. Most of the online brokerages that catered to individual buyers of technology stocks are in poor shape.

A few glimmers of hope, though. Headhunters are once again calling around about new jobs. The share prices of investment banks such as A.G. Edwards, Bear Stearns, Goldman Sachs and Merrill Lynch are up by over two-fifths from their September lows. In mid-March, results for many investment banks will be released, and they will no doubt be poor. What the market seems to be betting on is that they mark the bottom.

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Stockmarkets

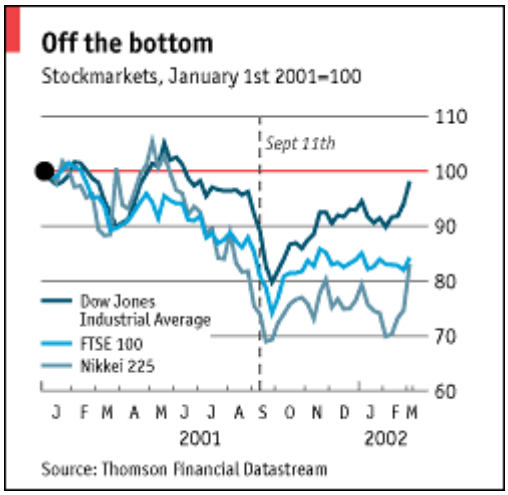
Long odds

Mar 7th 2002 | LONDON, NEW YORK AND TOKYO
From The Economist print edition

A bit of good news goes a long way

ANIMAL spirits, it seems, are back in the world's stockmarkets. From its lows after the September 11th attacks, America's Dow Jones Industrial Average has risen by 28%, and by 5.5% this year. In the past month, Japan's Nikkei 225 has jumped by 20%, while London's FTSE 100 index has risen by a less impressive 3% (see chart). The bulls point out that America's economy is rebounding.

Several economic indicators in America have indeed exceeded expectations, most notably a robust outlook for American manufacturers and good figures for fourth-quarter annualised GDP growth, which was revised upward from 0.2% to 1.4%. Indeed, if the GDP revision holds (it may be revised again), America will not have had a recession in the technical sense of two declining quarters of output.



The bulls are getting ahead of themselves, says Ben Rudd, an analyst at HSBC. He thinks that American share valuations look stretched, on a number of different measures. Investors seem to expect company profits to rocket: analysts' consensus estimates for non-financial companies in the S&P 500 index pencil in profit growth of 25% next year. Given the difficulty that American companies face in raising prices for their wares, Mr Rudd has estimated that they will need a 4.5% annual growth in sales volumes to hit this profit target. That, in turn, implies economic growth of roughly the same level: a tall order.

Price/earnings ratios (the share price divided by earnings per share) paint a similarly unreal picture. The S&P 500, for example, is trading at 29 times current earnings. Matthew Wickens at ABN-Amro reckons that fair value for American equities is 22 times earnings, compared with 17 for British shares and 19 for the euro-area. British and European share valuations are closer to this fair value, he estimates, than America's. There is little room for error, however, especially in the middle of the current season for reporting earnings.

Taking a longer-term view, Derry Pickford, an analyst at Smithers, a London investment advisor, reckons that judging from the ratio of stockmarket values to the replacement cost of companies' net assets (a measurement known as Tobin's Q), American equities are nearly two times overvalued. Much the same, he argues, holds for Britain.

In Japan, the stockmarket's rise may not be all it seems. One reason for the rally is the government's annual drive to prop up prices before the fiscal year ends on March 31st. This year, the government's assistance has taken the form of stricter rules on short-selling. It is also boosting markets thanks to hefty share-buying by trust banks managing public money. Analysts warn that the government's support will probably soon fade once the year-end is behind it.

Stockmarket bulls are confident that recent, upbeat data rule out a “double dip” recession in America—one where the economy picks up briefly, only to slump again before setting out on a full recovery. Any hint from economic indicators of such a dip is likely to unhinge shares, and to take the current high hopes with them.

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Japanese banks

Take from the old

Mar 7th 2002 | TOKYO
From The Economist print edition

Curious uses of depositors' money

Get article background

ON MARCH 20th a bunch of investors in Ishikawa Bank, a small regional bank in the west of Japan, will set out for Tokyo. Their leader, Yukinori Yoshizumi, a property agent, will hand a petition signed by 320 local investors to the Financial Services Agency (FSA). It asks the bank regulator to guarantee the ¥22 billion ($165m) of equity provided by investors for the benefit of Ishikawa Bank, eight months before the bank's collapse last December.

The petition raises questions for the industry and the FSA. When Ishikawa Bank closed its books for the year ending September 2000, it reported a 6% capital-adequacy ratio, easily exceeding the 4% required for domestic banks. When the agency subsequently inspected the same accounts, it discovered that Ishikawa Bank had a capital deficit instead.

At this point, the bank would normally have been shut down, or at least slapped with a “prompt corrective action” order to clean up its operations. Ishikawa Bank forestalled the regulator by raising the ¥22 billion in March and April, putting it back over the 4% threshold before the FSA's five-month inspection was completed in May 2001. The funds failed to turn the bank around. A second inspection, several months later, found more large holes. Ishikawa collapsed last December.

The petitioners are angry that a weak, unlisted regional bank, with little hope of attracting institutional or foreign investors, should have been allowed to turn to unsuspecting depositors and borrowers for fresh capital—only to collapse soon after. Pensioners who had never seen, let alone bought, shares before were persuaded to cash in deposits and buy equity out of loyalty to the bank. Weak corporate borrowers were also pressured. A borrower with, say, a ¥30m loan, would be asked to borrow another ¥10m and buy shares with the extra cash.

Tough, says the bank regulator, this is market capitalism at work. Still, some investors should be able to sue the bank for misselling shares: it seems to have forgotten to give them share prospectuses. Even those who saw the prospectus, published at the time of the FSA's inspection, note that it claimed a capital-adequacy ratio of 6%. This figure proved to be incorrect even as the shares were being sold, or soon after. The regulator still insists that the bank provided enough data for financially literate investors to see that it had a deficit. Financial professionals looking at the documents now say they are unable to spot the clues, so retail investors stood little chance.

Selling shares to borrowers raises separate risks for the banking system, which has ¥150 trillion of bad debts as it is. It leads to double-gearing, where banks and weak borrowers prop one another up, by holding each other's shares or debt. This raises the risk of a single bankruptcy triggering others. Borrowers at Ishikawa Bank, who increased their liabilities in order to buy the bank's shares, are now in more danger of going bust than they otherwise would have been. Presumably the FSA, as a prudential regulator, should discourage such practices. The agency replies that if weak borrowers are pressured into buying shares in creditor banks, it is their own fault for not being healthy enough to say no and take their business elsewhere.

How could Ishikawa, a licensed bank, have been so off the mark in its accounting? The FSA's response is that not all banks manage to figure out their true state of affairs until their books are inspected by the regulator. This raises fresh questions. How many banks like this are there, and are they inept or are they lying? And how does this square with repeated assurances from the minister who heads the FSA, Hakuo Yanagisawa, that banks' self-assessments can be trusted?

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American International Group

Value disputes

Mar 7th 2002 | NEW YORK
From The Economist print edition

How much is AIG really worth?

AFTER our story last week on AIG, Sanford Bernstein, a Wall Street research house, issued a long response (click here for excerpts from its response). In particular, Bernstein examined our contention that if AIG were priced similarly to peers in each of its various business lines, its market valuation of $190 billion was either $100 billion too high, or it was based on the assumption that AIG could grow two-thirds faster than could its competitors—for the next quarter-century. By contrast, Bernstein puts a value on AIG of $236 billion. The stockmarket, for now, appears to lean Bernstein's way, for AIG's market capitalisation has risen to nearly $200 billion in the past week.

Bernstein contends that if AIG were valued on a par with more ordinary insurance companies, it would be worth $135 billion-150 billion. Bernstein then adds $92 billion more for “what AIG can do in the future that it does not do now”. Our contention is based on work by Seabury Insurance Capital.

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Alternative insurance

A strange menagerie

Mar 7th 2002
From The Economist print edition

Alternative risk transfer cannot replace traditional insurance

IN the 1980s, when insurance got expensive, new forms of risk transfer were born. They were supposed to provide an alternative to traditional insurance. But as soon as premium rates came down, interest in these animals waned. Now that insurance is expensive again, and some forms of cover hard to get, will alternative risk transfer (ART), as it is known, take off?

The market is tiny, roughly 8% of the total market for commercial insurance, and potential customers are still not familiar with the various and complex types of ART. Moreover, some of the mechanisms involved do not actually transfer risk; they are more like self-insurance or a new source of finance.

Alternative ways are used mainly by captive insurance companies. These are insurance or reinsurance vehicles that belong to one or more companies not chiefly involved in insurance. Captives, which insure the parent companies' risk, still take the lion's share of the alternative-risk market. More than half of existing captives belong to American companies, and they tend to be set up in tax-friendly Bermuda.

Most captives have just one parent. For parents with good risk, self-insurance through a captive avoids the snags of pooling risk. Companies with good risk do not have to subsidise those with bad. Nor are captives likely to suffer moral hazard—the temptation not to prevent or contain a loss. Moreover, companies can influence the way their captives invest, and how much reinsurance they buy.

Captives are in vogue today because some companies have little choice but to carry their own risk: last year 108 new captives were founded in Bermuda alone, more than double the number set up in 2000. America's aviation industry, hit by high insurance costs after September's terrorist attacks, is trying self-insurance. Under the codename Equitime, the Air Transport Association, a trade group in Washington, DC, and Marsh, an insurer, are working to set up a captive to cover war risk. The federal government is in favour of the plan, under which it would continue to act as insurer of last resort for the very biggest losses.

Much newer ART creations, such as insurance-linked securities, are also more in demand today than they used to be. Catastrophe (“cat”) bonds were invented in 1994: in a typical transaction, a company enters a reinsurance contract and issues bonds to investors. The yield is a few percentage points higher than that on conventional bonds—but, if the catastrophe occurs, investors lose interest, principal or both. Catastrophe bonds are expensive for the company that issues them. Moreover, investors are uncomfortable with the risk of losing everything should the catastrophe hit.

The industry does not agree on the outlook for catastrophe bonds. Swiss Re, one of the biggest players in the ART market, predicts that by 2010 about $10 billion of cat bonds will be issued every year, compared with around $1 billion in recent years. On the other hand, Jacques Blondeau, chief executive of SCOR, a French reinsurer that recently launched two new catastrophe bonds, doubts that the market will grow significantly. At present, catastrophe bonds represent about 0.7% of the reinsurance market worldwide.

Reinsurance with an upper limit (finite insurance) is likewise still small beer. For example, spread-loss treaties are typically fixed-term contracts under which the insurer pays the reinsurer a fixed, annual premium in exchange for the ability to claim a total of, say, five times that premium at any time over the period of the contract. Swiss Re and MBIA, a company that provides financial-guarantee insurance, recently struck the first finite-risk deal since September 11th. Finite insurance is, however, wrongly described as alternative risk transfer: risk is not transferred, just made financially less lumpy.

The success of alternative risk transfer depends on the price of insurance. Robert Mendelsohn, chief

executive of Royal & SunAlliance, a British insurer, thinks prices for insurance will remain high for a while. On the other hand, Warren Buffett, head of Berkshire Hathaway, an American insurance conglomerate, believes insurance rates will fall again soon. Either way, a substitute that becomes attractive only when the real thing is in short supply, is surely no true alternative.

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Bank of China

Cleaning up

Mar 7th 2002 | HONG KONG
From The Economist print edition

Contrary to appearances, there is progress at one state-owned Chinese bank

“WHAT'S going on inside the Bank of China is the opposite of how it looks at the moment,” says Shan Weijian, an independent director of its Hong Kong subsidiary. Certainly, the news since January has been awful. The bank's former chairman is being investigated for fraud and corruption, while the bank itself has been fined by Chinese and American regulators, and is being sued in New York. An initial public offering of shares in its Hong Kong subsidiary has been delayed.

The Bank of China was meant to be the model of reform. Yet, by the late 1990s, something like half of the loans in China's state-controlled banking system were bad. If the four big state-owned banks that dominate lending—the Industrial and Commercial Bank of China, the China Construction Bank, the Agricultural Bank of China and the Bank of China—applied international accounting rules to their business, they would certainly be insolvent. Reform is a priority. The government has hived off many of the bad loans into separate vehicles where they can be written off, nursed back to health, or sold. To prevent the state banks from piling on new bad loans, Beijing is trying to tighten their governance and risk management.

The Bank of China was always the natural leader for reforms. Unlike the other three banks, which for most of Communist China's history acted as the central planners' cashiers, the Bank of China dealt mostly with China's foreign-exchange transactions and trade finance. Only the Bank of China has big overseas operations, which make virtually all its profits.

Even so, the bank always attracted gossip. China maintains exchange controls. At the same time it suffers capital flight, and there are only so many exit routes. In the 1990s rumours grew of suspect transactions by the bank's New York branch. For some time, the branch was run by Wang Xuebing, who went on to become chairman of the whole bank. By 2000, it seems, the government saw Mr Wang as a liability to the bank's reforms. It moved him to another state bank; then, in January, Mr Wang was detained, under suspicion of so far unspecified crimes. This is now known as “the Wang incident”.

The man who replaced Mr Wang as chairman in 2000 is Liu Mingkang. People who know both men well say that Messrs Wang and Liu are opposites: Mr Wang had a reckless streak in his personal dealings—with expensive hobbies and a taste for power—but displayed conservatism as a reformer. Mr Liu, by contrast, is a bit of a puritan. When an American bank, J.P. Morgan Chase, invited him and his wife to a conference in Hawaii, he insisted that she buy her own ticket, in economy class. Moreover, he has shown boldness in reforming his bank. Mr Wang had powerful backing in the state council, China's cabinet, and Mr Liu certainly took risks by opening the files.

The planned share listing of the Hong Kong operations, perhaps later this year, is a test of the governance and management models that Mr Liu hopes to bring to the parent company. The Hong Kong operations have existed as an identifiable corporate entity only for half a year. Before that, the Bank of China owned a stable of 13 banks in Hong Kong and Macau, with almost no co-ordination among them. Mr Liu's first step, last October, was to merge them and integrate their back offices. His next goal is to unify their risk management, putting in computer systems that assign internal credit ratings for borrowers and allow risks to be managed more professionally; and putting loan officers through finance courses at London's City University (where Mr Liu also studied) to develop a credit culture.

Mr Liu has left his clearest mark on the subsidiary's brand-new board, which he chairs. Four of the 13 directors are independent and tough. One, Peiyuan Chia, is a former director of Citibank in New York. Another, Victor Fung, is an outspoken Hong Kong tycoon and financier who used to lecture at Harvard Business School. Mr Shan, the third, is a director of Newbridge, an American buy-out firm that specialises in banks. The fourth, Chee-chen Tung, is a tycoon who happens, admittedly, to be the brother of Hong Kong's chief executive. Mr Liu has also hired two advisers with credibility in matters of corporate governance: Anthony Neoh, a former head of Hong Kong's securities regulator and current adviser to the mainland's, and Lawrence Lau, an economics professor at Stanford University.

According to the minutes, these independent directors and advisers do most of the talking (in English) during board meetings. They run the audit committee and sit on the compensation and risk-management committees. The Wang incident occurred just as they wrapped up their last meeting, in January. The chairman of the audit committee has since had brought to him details of every lawsuit pending in any part of the group. At least 15 people are examining the files before the board meets again, next week. It is the closest scrutiny a Chinese bank has ever had.

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Cost-of-living in war zones

Antonov with fries

Mar 7th 2002 | LUANDA
From The Economist print edition

Distorted war economies

A WIMPY mega-cheeseburger in Luanda, Angola's capital, comes with more than the usual chips and ketchup. The view, from a beachside perch, is of Antonov planes lumbering home from the civil war; sprawling slums near the docks; and queues of oil tankers. The price tag is unusual too. A “beefy composte”, as some locals call it, costs 225 kwanza ($6.40), four times its price in much wealthier South Africa. Fish and chips are 440 kwanza, nearly eight times more. It is not just the burger bar, which Wimpy in South Africa disowns. Everything in Luanda is expensive. A tank of petrol is 3,000 kwanza, a tot of whisky 700 kwanza, a minute's phone call across town several dollars. Why is the rubble-strewn city so costly?

Angolans are among the worst-off in Africa. After three decades of fighting, the economy is in tatters. Soldiers have forced most farmers into cities and planted landmines in their fields. Once a big exporter of maize, coffee and cotton, Angola now depends on the World Food Programme to keep its people alive. Still, those with money, an elite that is extremely rich from oil, have almost nothing to spend it on, aside from shopping trips to Johannesburg, Lisbon or Paris. So traders import absolutely everything they need. The tomato sauce, onions, cheese, flour, potatoes and meat for that burger are flown 2,400 kilometres from South Africa—as is everything in Luanda: the paper napkins, plastic menus and cooking oil, bottled water, flashy cars, toilet seats, insect repellent. Oil money makes this an extreme example. But it is a similar story in other isolated and war-torn parts of the world. Cities are costly where United Nations staff, diamond traders, aid workers, diplomats, mercenaries and gun-runners compete for the few available hotel rooms, bottles of water and reliable taxis. Angola's central bank ensures an overvalued kwanza (says the Economist Intelligence Unit, a sister organisation), which helps traders import those goods.

In Freetown, the smashed-up capital of Sierra Leone, where hotels charge New York prices for rooms and meals, another moneyed elite (both local and foreign) inflates the price of everything from toothpaste to bananas. When enough peacekeeping soldiers flood into a little country, as in Eritrea, or journalists into small towns, as in western Pakistan recently, prices of everything shoot up. But can anywhere rival Luanda's fake Wimpy? Only Myanmar, where there is an equally false McDonald's burger bar, complete with sinister clown in the window.

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Economics focus

An eye for an A

Mar 7th 2002
From The Economist print edition

Price inflation is subdued these days. Academic grade inflation appears to have taken up the running

ECONOMISTS are not the only ones who fret about inflation. Lately, presidents of some American universities have also added it to their worry list. One man who is both an eminent economist and a university president—Larry Summers, at Harvard—stirred up particular excitement over the subject recently. He is concerned about inflation not of prices, but of academic grades, and he caused a storm when he told one of the university's professors he didn't like it.

An internal study shows that nearly half the grades Harvard awards have lately been A or A-minus—a lot more than in the 1980s. Surely, outsiders mock, this grade inflation is but a symptom of a wider dumbing-down in America's universities: a symbol of the country's obsession with self-esteem, as opposed to self-improvement.

Without the benefit of a Harvard education, they would say that. But the trend does seem a little odd. Is it such a bad thing, in fact? This column also feels obliged to ask, pedantically, whether grade inflation really is “inflation”.

To take the second question first, the answer is, No, not strictly speaking. If you take the metaphor seriously, “inflation” in grades ought to mean that work of a given standard would be awarded an ever higher grade, year by year. The highest permissible grade would therefore have to keep rising: A this year, A-star the next, A-double-star and so forth thereafter, in a ceaseless procession of non-improvement. Because in reality the top grade is fixed, the process is not so much grade inflation as grade compression. This is worse: a distortion in relative prices is more confusing than a uniform upward drift. Grade compression squeezes information out of the system. At the limit, when all Harvard's students get As all the time, the university's grades will yield no information whatsoever.

Fixing the proportion of students awarded each grade would avoid grade compression—but this might squeeze out information in another way. After all, it may indeed be the case that the changing distribution of grades reflects improvements in the quality of students. Harvard has attracted record applications in the past few years. Some maintain, with straight faces, that each class is cleverer than the last—a hard thing to disprove.

But is grade inflation necessarily a bad thing? The answer depends on who you are. When students leave Harvard, they carry grades as a sort of currency: a pocketful of intellectual capital, to bid for jobs or places in graduate schools against graduates from other universities with other currencies. These positions go to those who can put the most academic cash on the table. Employers and graduate schools must decide on the exchange rate, as it were, between a Harvard C student (a rare thing, these days) and an A student from a less distinguished place.

Again, overall grade inflation—the uniform devaluation of the students' capital—would be relatively easy to cope with, working in principle neither to the advantage or disadvantage of Harvard graduates. Recruiters, in a position to see the market for graduates as a whole, would simply adjust their exchange rate. Compression, however, has distributional consequences. The best Harvard students see their grades devalued relative to those of mediocre Harvard students. That is bad for incentives.

Enough, already

In practice, adjustment to overall grade inflation is unlikely to be smooth: there may be gross exchange-rate misalignments, as well as relative-price distortions. As with workers and wages, one needs to think about how recruiters form their expectations about future grade inflation. If employers are “rational”—if the assumption is that Harvard is inflating its grades, and will continue to do so—then they can apply an appropriate deflation factor. If they are “adaptive”—how surprising, Harvard inflated its grades again last year (but surely won't do so again)—Harvard students will benefit, and keep on benefiting, from recurring episodes of grade illusion.

The possibility that grade illusion will deliver gains to students, as well as merely flattering their intellectual vanity, and the undoubted fact that it makes life less demanding for the faculty (less work, less irritation), create a strong incentive for universities to inflate and compress. Soon, inflated and compressed grades will be the norm and fair grades the exception: a kind of Gresham's Law, you might say, with bad grades driving out good.

A kind of Gresham's Law, you might say, with bad grades driving out good

Good, stable currencies are hard to create and should not be abandoned lightly. But once the debauching has begun, it is hard to stop—as Mr Summers is discovering. Yet he and Harvard need not despair. Once the professors have reduced their grades to an absurdity, and rendered that particular currency worthless, other units of account will necessarily spring up to take its place: recommendations from professors, “personal essays”, interviews, standardised tests—areas in which students from the most inflated universities happen to excel. The spur to competition will remain, the information will continue to flow. But watch out, faculty members: these alternative currencies sound as though they involve more work and trouble than simply giving true grades in the first place.

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About sponsorship

Academic freedom

Secrets and lives

Mar 7th 2002
From The Economist print edition

How should the needs of academic enquiry and national security be balanced?

IN 1982, during the cold war, Ronald Reagan's administration tried to block the presentation of 100 unclassified scientific papers at an optical-engineering meeting in San Diego. The move was hotly contested and the government backed down. At about the same time, the FBI was taking an interest in whether people with “Russian-sounding names” were looking at scientific journals in some university libraries. The State Department also requested that Chinese scholars and students should be denied access to computer-science journals kept in plain sight within university reading rooms.

Knowledge is power. Those who possess it have always sought to deny it to their enemies, particularly if it has military applications. But exactly what knowledge needs to be controlled depends on who those enemies are. Nor is the control of knowledge costless. A free society should regard it as a last resort. Scientists cannot build on each other's results if they do not know them. And governments are frequently tempted to hide not only what is dangerous, but also what is embarrassing. That can result in dangers of its own.

Nevertheless, the past six months have shown that the West in general, and America in particular, has new enemies. New controls are therefore being discussed as politicians and scientists try to work out a reasonable boundary between openness and secrecy. The centre of the discussion, however, is no longer the physics of explosive weapons, whether conventional or nuclear, that weighed so heavily in the balance of power during the cold war. It is the technology of biological warfare.

Publish and perish?

In the past few years, people on both sides of the Atlantic have debated whether terrorists would find biological weapons a useful tool. That debate came to a halt in September, when letters containing anthrax were found in America's mail. This was not, in fact, the first incident of bioterrorism in America. In 1984 the members of a cult in Oregon caused a *Salmonella* outbreak by infecting salad bars with the bacterium. As a result, 751 people became ill, although no one was killed. But the heightened atmosphere of fear has led many people to consider other possibilities seriously. What if the terrorists had used smallpox? What if genetically modified pathogens had been released?

The United States accordingly passed a law in October to tighten restrictions on who was allowed to handle certain toxins, viruses and micro-organisms. That was widely seen as reasonable. But another proposal, to bar non-resident aliens from possessing these agents, is worrying academics because it could restrict collaboration with, among others, Canadian and British researchers. George Poste, the British-born former head of SmithKline Beecham, said these were “xenophobic, anti-intellectual proposals that are alien to the ethos of the United States”.

The views of a foreign-born scientist, even one who has taken American citizenship, might not be expected to cut much ice in Washington. But Dr Poste is no ordinary foreign-born scientist. He chairs a Department of Defence task force on bioterrorism and sits on the department's advisory Defence Science Board. He is also a realist. In November 2001 he told *Nature* that biology must “lose its innocence”. He

criticised biologists for their naivety in failing to consider possible malign applications of data derived from their work.

One of Dr Poste's concerns was projects that use viruses as “vectors” to introduce therapeutic genes into an organism. These viral vectors often attract the attention of the immune system, which seeks to eliminate them, so some researchers are engineering “stealth” vectors that can evade or manipulate the immune system in order to deliver their genetic payload. That would have medical advantages. The flip side, though, might be the creation of a pathogenic virus that was immune to the immune system.

That this can happen was demonstrated last year when a group of Australian researchers revealed that they had inadvertently created a super-virulent strain of mousepox while working on a contraceptive vaccine. That was an accident, but the scientists were worried that a similar, deliberate, genetic manipulation could have the same effect on smallpox. After much discussion, they published their results, saying they felt that the topic had to be brought into the public arena.

Big brother is watching you

Were they right to publish? Not everyone thinks so. In December, rumours started that a number of American biology journals were under pressure from the White House to restrict information that could be helpful to terrorists. Although these rumours were quashed by the government, they resurfaced later in a story in the *New York Times*, before being denied once again.

Bob Park, a physicist at the University of Maryland, has been an observer of science-related activity in Washington since the time that the Reagan administration attempted to create a new level of government secrecy: “sensitive but unclassified”. He remembers the arrest of officers of the American Vacuum Society for allowing scientists from China to attend that society's annual meeting. He has been watching the issue of secrecy in science unfold for a second time, albeit in biology. It is quite clear, he says, that the president of the American Society for Microbiology (ASM) was “summoned to the White House and accused of publishing papers that benefited terrorists, or could have benefited terrorists, and instructed to go off and prepare a set of guidelines.” Ronald Atlas, president of the ASM, says this is inaccurate. He says the society has entered a dialogue with some members of White House staff on the issue of whether the ASM journal that published the mousepox paper should have done so. But, in any case, the journal editors, aware of the issues involved, had decided that the public health benefits of publishing the paper outweighed other considerations.

The federal government is planning further steps. The recently established Office of Homeland Security (OHS) is working on a new information-security policy. The OHS is responsible for co-ordinating American strategy against terrorist attacks or threats, and wants to issue detailed guidance for identifying and safeguarding sensitive information. It will not discuss any aspect of this guidance yet, but scientists are already worried about what it might contain.

It certainly seems that federal agencies will—quite reasonably—place more emphasis on assessing the risks of a piece of research before agreeing to fund it. More worrying, from the scientists' point of view, is that new areas of bioscience may become classified, that the government is considering reviewing work prior to publication (with an option on refusing permission to publish) and that it might insist that the methods sections of some research papers are removed. The OHS may also be considering re-introducing the Reagan-era idea of “sensitive but unclassified” information in academia. Dr Park says that this was in some ways the most dangerous level of secrecy, because it was not defined clearly in the legislation and there were no channels of appeal.

These would be big changes. At the moment, far from promoting secrecy, many federally funded agencies require that research results be put into the public domain. In particular the National Institutes of Health (NIH), which is the largest source of federal money for biological research, does not support any classified research—although a recently issued executive order may alter this.

Anthrax is a case in point. Researchers at the Institute for Genomic Research (TIGR), in Maryland, are being paid by the NIH to sequence the genome of *Bacillus anthracis*, the bug that causes this disease.

They intend to publish the sequence soon in a scientific journal (much of it is already available on the web). Their intentions, however, may be thwarted. TIGR has heard several off-the-record suggestions that publication might be blocked. Yet that could be counterproductive. Those supporting publication of the sequence say that any delay would stifle research that might help to prepare for bioterrorist attacks in the future.

Whatever the details of individual cases, classifying a particular piece of research as secret, or not, is at least clear-cut. Partial censorship—especially the idea of eliminating the methods sections of some scientific papers—is much more insidious. Science progresses as the work of one group is reproduced and verified by others. But if a paper lacks a methods section, there is no way of verifying whether the results were simply invented. And all forms of scientific censorship bring another subtle threat. Scientists' reputations, and therefore their careers, depend on publication. There can be few surer ways to drain scientific talent from a country than to stop that talent telling the world what it has achieved. For America, a country that depends on the advancement of science for much of its success, that consideration is worth thinking about.

The past, and other countries

American researchers are not the only ones who are worried. British scientists also feel threatened. In the physical sciences American researchers have argued for years with the government over the declassification of documents and the application of export-control restrictions—particularly in the area of cryptography. America's experience in the 1980s shows how easily politicians can alter the focus of such legislation. Reinterpreting export-control restrictions to cover scientific communication, including that at meetings involving foreign scientists, was the basis of many of the Reagan-era controls.

It is for just such reasons that many British academics are alarmed by the Export Control Bill currently passing through their country's parliament. This bill, if enacted, would regulate the export of “dual-use” technologies: those that have legitimate civilian roles, but might also be turned into weapons.

That is reasonable enough. But the bill would also, for the first time, regulate such transfers within Britain. And technology, within the meaning of the bill, includes ideas, as well as things. For those who favour the free exchange of ideas, that is a worrying trend. The government says it has no intention of restricting academic freedom. Academics counter that, if the government really does not want powers to prevent either the publication of results or contact between scientists, then it should not be taking them.

The fruits of past research are also under threat. According to the American State Department, 30m pages of once-public declassified documents have been withdrawn, while another 20m that have been declassified but not yet released are awaiting review (a task that is expected to take five years). Some people regard the withdrawal of previously public data as tokenism. It may be worse than that. Removing, say, information on security weaknesses at nuclear-power plants from public scrutiny may help to prevent attacks. On the other hand, covering up security weaknesses does not eliminate them. One of the withdrawn documents reported that it took a two-man “SWAT” team an average of 22 seconds to breach security at American nuclear plants. Making such information public brings pressure to bear to improve things.

Priorities, priorities

Such matters clearly need to be debated openly—and not just by scientists and politicians. In December, the American Association for the Advancement of Science held a seminar on the war on terrorism and what it means for science. John Marburger, the new director of the White House Office of Science and Technology Policy, said he wanted to “cool any fever” that the course of discovery would be interrupted and the quality of intellectual life distorted and impaired, or that science was to be diverted in a massive way as it was in the second world war. Some academics, though, are already questioning the amount of funding that is being poured into bioterrorism.

A sense of proportion is certainly important. Five deaths from anthrax are five too many. Food-borne illnesses, though, put 325,000 people in hospital and cause 5,000 deaths a year in America. The threat from immoral humans must be balanced against the threat from amoral nature. It is not always right to stifle research that may fight the latter because it may aid the former. As the events of September 11th showed, the most unlikely sorts of technology can turn out to be “dual use” in the hands of a bold and creative enemy. Censoring the publication of research into aircraft technology would have stifled

innovation without helping the people in the World Trade towers. That might sound a facile point, but only because aircraft are so familiar and were, until recently, so unthreatening. Censoring biomedical research risks stifling medical progress—not least in countering the diseases that bioterrorism might unleash.

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About sponsorship

Table-top fusion

Here we go again

Mar 7th 2002
From The Economist print edition

Is the world about to witness a repetition of the cold-fusion fiasco?

AS PARENTS scare their children with stories of ghosts and ogres, so professors scare their students with stories of Pons and Fleischmann. In 1989 Stanley Pons and Martin Fleischmann, then researchers at Southampton University, in England, announced to an astonished world that they had performed nuclear fusion in apparatus built on a laboratory bench. For a few weeks people dreamed of limitless clean power. But other researchers failed to replicate their results and it was clear that a mistake had been made. Dr Pons and Dr Fleischmann were disgraced, and now labour in obscurity.

This week's *Science* includes a paper that makes similar, albeit more guarded, claims. The technique is different, but the apparatus still fits comfortably on a bench top. This time, the researchers do not state that they have seen fusion, but merely phenomena consistent with it. However, the subtext is clear: they think they have got there. Unfortunately, the ghost of hubris past will not let go of the subject. Another group of researchers has already claimed that it cannot replicate the trumpeted results.

Fusion involves colliding small atomic nuclei together to form larger ones, a process that releases energy. But, since atomic nuclei are positively charged, and like charges repel, it is a hard trick to pull off. It happens in the cores of stars, where high pressure squeezes nuclei close together, and high temperature means that they are travelling so fast that they overcome the repulsion. It can also be made to happen briefly on earth in huge machines that replicate stellar conditions.

These machines fuse nuclei of deuterium, a form of hydrogen that has a proton and a neutron in its nucleus, rather than the lone proton of normal hydrogen. When two deuterium nuclei fuse, they may form either tritium, a still heavier form of hydrogen that has a proton and two neutrons (a reaction that releases a proton), or a form of helium that has two protons and a neutron, thus releasing the surplus neutron. Deuterium is abundant, in effect forming an infinite potential fuel supply. But the machines are reckoned to be 50 years from commercialisation—and have been for most of the 50 years since people first started trying to build them.

A different, smaller-scale fusion technology could be a real boon. And the method described by Rusi Taleyarkhan, of Oak Ridge National Laboratory in Tennessee, and his colleagues looks plausible. Unlike Dr Pons and Dr Fleischmann, who used a technique derived from electrochemistry, Dr Taleyarkhan thinks he can generate the temperatures and pressures required by acoustic cavitation.

This involves sending powerful sound waves through a liquid. During the low-pressure trough of a wave, bubbles of vapour form in the liquid. During the high-pressure peak, these bubbles are squeezed into oblivion. The intense heating associated with this squeezing produces light—a phenomenon called sonoluminescence that has been known for a century. Many people have suspected that it could also be enough, combined with the high pressure involved, to promote fusion.

Dr Taleyarkhan and his colleagues picked acetone, whose molecules contain six hydrogen atoms, as the liquid. They ran the experiment with normal acetone, as a control, and with acetone that had been made with deuterium, rather than ordinary hydrogen. As they did so they looked for the release of neutrons of the energy associated with deuterium fusion. In the former case they found none. In the latter, they found significant numbers. They also analysed the acetone after the experiments, looking for further neutrons produced by the radioactive decay of tritium. These, too, were present in the experimental samples, and absent from the controls.

All of which would look pretty promising if Dan Shapira and Michael Saltmarsh, two of Dr Taleyarkhan's colleagues at Oak Ridge, had not written to *Science* a few days before publication saying that they had

repeated the experiment with the same equipment, except that they used a different sort of neutron detector. They could, they said, find no sign of a neutron flux big enough to indicate anything approaching fusion.

Dr Taleyarkhan has replied that his critics did not understand their own results, which actually did show a flux of neutrons consistent with his own interpretation. The consequence is likely to be a big kerfuffle until yet further replications are carried out, ideally not at Oak Ridge, whose coffee room is now presumably at daggers-drawn. Watch this space.

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September 11th and after

Us and them, or us and us?

Mar 7th 2002
From The Economist print edition

Mary Evans

Three books about the world seen from America, and one about America seen from the rest of the world

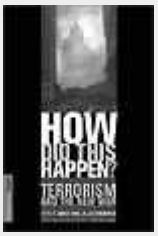
"HOW Did This Happen?" and "The Age of Terror" are collections of essays on September 11th and its implications, written in the main by American foreign-policy specialists, many of them with government experience. There is no need to turn to the authors' brief biographies to check which administration they served. The tone throughout is non-partisan, single-minded and steely, as you would expect of a nation that finds itself at war.

The first volume, put together by the editors of *Foreign Affairs*, ranges wider in terms of analysis and policy. Richard Betts, for example, sets American intelligence successes in counter-terrorism besides the failures. Alan Wolfe, in a piece called "The Home Front", remarks on American pragmatism and, Jerry Falwell's crowd aside, a notable lack of hysteria. Presciently, Michael Mandelbaum describes the policy consequences of September 11th as a sharp focusing of diplomacy, a loosening of restraints on the use of force, (minority) calls to tackle the causes of terror, and the urgent removal of certain types of government. Did Saddam Hussein get a proof?

"The Age of Terror", co-edited by Strobe Talbott, an ex-deputy secretary of state, has longer, more ruminative essays about American power and strategy. Two British historians—Paul Kennedy, now at Yale, and Niall Fergusson of Oxford University—play Athenians to the new Rome by turning to the past for lessons. Perhaps the outstanding essay here is from John Lewis Gaddis, the dean of American diplomatic historians. He reflects from a height on America's foreign-policy failures in the 1990s, and calls on it now to assume its world responsibilities more consistently.

In other respects, these two collections converge. Both tend to agree that September 11th was neither the first exchange in a clash of civilisations nor a strike against the rich from the wretched of the earth. Those heinous attacks are treated rather as a blowback from conflicts within the Middle East. American readers will probably find many of the points and arguments familiar. Non-Americans should read these two books if only to hear for themselves—and in

How Did This Happen? Terrorism and the New War
Edited by James F. Hoge and Gideon Rose



Public Affairs; 324 pages; $14 and £8.99

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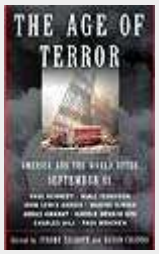
The Age of Terror: America and the World After September 11
Edited by Strobe Talbott and Nayan Chanda

detail—how unified American foreign-policy thinking has become.

Joseph Nye's book shows signs of having been written before September 11th and lightly updated. He was a top defence-and-intelligence official under Bill Clinton and is now dean of the Kennedy School of Government at Harvard. His sub-title is “Why the World's Only Superpower Can't Go It Alone”. Before September 11th, this would have been given—and taken—as criticism of the new Bush administration. Most, indeed, of this elegantly constructed essay is about why an unrivalled military and economic power still needs allies or partners, and why, as world leader, America should rely also on the soft, persuasive kind of power: the appeal of its values and culture. Even Mr Nye's multilateralism is tempered, however. Without rebuffing international support, America should be ready to go it alone, he says, to protect vital interests or when co-operative solutions become, as he puts it, recipes for inaction.

The *Granta* collection, “What We Think of America”, is in another vein entirely. Ian Jack, the editor of this London-based literary quarterly, asked 24 non-American writers across the world to describe their first encounter with America and what the country means to them now. Is America, he asked them, really so disliked? If so, why? You would be wrong to expect here a set of anti-American sermonettes. With exceptions, these short pieces express admiration—love, even—for Americans and American life. The ifs and buts are for American policies. For a nation at war, that distinction, of course, will not easily wash. All the same, this small, intelligent collection should be read by anyone who is distressed at the gap in comprehension that is threatening to open between Americans and their non-American friends.

How Did This Happen? Terrorism and the New War.
Edited by James F. Hoge and Gideon Rose.
Public Affairs;324 pages; $14 and £8.99



Basic Books; 232 pages; $22 and £15.99

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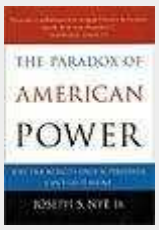
The Paradox of American Power: Why the World's Only Superpower Can't Go It Alone
By Joseph S. Nye



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What We Think of America
Edited by Ian Jack

Granta 77; 254 pages; £8.99

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About sponsorship

Intelligence and secret government

Lifting the curtain

Mar 7th 2002
From The Economist print edition

DESPITE their British focus, these two books raise important questions about modern intelligence-gathering generally. How effectively does it serve national security? How can it be politically controlled?

Between 1992 and 2000 some 96,000 closed files were made available in Britain's Public Record Office. Many touch intelligence, nuclear policy and defence strategy—particularly the files of the Joint Intelligence Committee (JIC). The committee was set up in 1936 and incorporated into the cabinet structure in the 1950s. Its job is evaluating (mostly secret) information affecting British interests. Files down to the late 1960s are now public, albeit with notable omissions (for example, the records, of the intelligence and counter-intelligence services themselves).

From this material, Sir Percy Cradock, who chaired the JIC from 1985 to 1992, has compiled both its history and an insider's view of major post-war crises. Despite the acknowledged gaps, readers will get from his book a fair picture of the limits of intelligence work and perhaps a better idea of what it can realistically be expected to achieve.

A large part of the JIC's work throughout the post-war period was concentrated on Soviet military strategy, and on the chances and consequences of a Soviet attack. How the British government treated that threat is the topic of this new book from Peter Hennessy, a professor of history and government who successfully campaigned for the release of closed files.

“The Secret State” describes in discouraging detail official preparations made to fend off nuclear destruction. Much here reads like a script from the contemporary satire show, “Beyond the Fringe”. But much of it was serious, and Mr Hennessy himself has a serious point. Whitehall was in charge of preparations, with only limited accountability to parliament—further material in the debate about the passing of cabinet government in Britain.

Know Your Enemy: How the Joint Intelligence Committee Saw the World.
By Percy Cradock.
John Murray; 351 pages; £25

The Secret State: Whitehall and the Cold War 1945-1970.
By Peter Hennessy.
Allen Lane, The Penguin Press; 224 pages; £16.99

Know Your Enemy: How the Joint Intelligence Committee Saw the World
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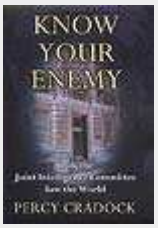

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The Secret State: Whitehall and the Cold War 1945-1970
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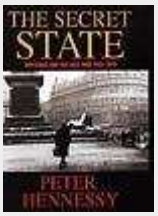

Allen Lane, The Penguin Press; 224 pages; £16.99

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About sponsorship

Financial swindlers

Pro and con

Mar 7th 2002
From The Economist print edition

ALEXANDER STAVISKY was a Ukrainian-born conman who came to Paris in 1900 and took French citizenship in 1914. Under a new name (to put behind him a period in custody on a charge that never came to trial), he graduated from selling phoney health foods and fake refrigerators to forging bonds with which to loot municipal credit agencies. Along the way, he lived like a prince and won influential friends until finally, in January 1934, his number came up. He was found dead in a modest villa in Chamonix, officially a suicide, though some insisted that he had been murdered for political reasons.

Stavisky: A Confidence Man in the Republic of Virtue
By Paul F. Jankowski

Cornell University Press; 352 pages; $35

Buy it at
Amazon.com
Amazon.co.uk

The public uproar that followed shook France's third republic to its roots: the government of Camille Chautemps fell as rioters took to the Paris streets demanding the punishment of the notables whose endorsement of Stavisky had kept his scams alive. One senior judge, who had turned an expedient blind eye, was found dead beside a railway track. Several of the great and good went for trial, and France's voluble right-wing press indulged itself in a wave of anti-Semitism and xenophobia.

In its way, this is a fascinating story, first told by Paul Jankowski, a history professor at Brandeis University, more than a year ago, in the original French version of this book. He delves into the archives, carefully noting every item, to set Stavisky, a naturalised Jew, into the French context of his time: a weak democracy with a sick economy in a Europe sliding towards fascism and dictatorship.

Fake fridges, anyone?

But there are two things missing from the story as it is told here. One is a sense of Stavisky himself. For all the meticulous research, it is the minor characters, not the chief villain, who emerge most clearly. The other is a sense of how, given human frailty, the so-called republic of virtue could have devised a better way to ensure an independent judiciary, a responsible legislature and an honest press.

Seven decades on, though the overall context is very different, France is still struggling for an answer. Dozens of top French businessmen and politicians have been investigated, arrested or convicted; only constitutional immunity keeps the president himself from a judicial inquisition; and Alfred Sirven, a bank-robber turned senior executive of the former state oil company, Elf Aquitaine, is threatening from his prison cell to spill secrets that could, he claims, “topple the republic 20 times over”.

Stavisky: A Confidence Man in the Republic of Virtue.
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About sponsorship

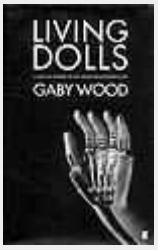
Robots in history

Imitation of life

Mar 7th 2002
From The Economist print edition

MACHINES that imitate life, or automata, became popular as expensive playthings during the 18th century. From glorified clocks they quickly evolved into a procession of mechanical dancers, birds and musical figurines of increasing complexity. Operating at the intersection of science, commerce and entertainment, they enabled ideas to flow freely between these fields and spawned technologies and manufacturing techniques that later helped to fuel the industrial revolution. The men who made them, as Gaby Wood relates in “Living Dolls”, were driven by the desire to play God.

Living Dolls: A Magical History of the Quest for Mechanical Life
By Gaby Wood



Faber and Faber; 278 pages; £12.99

Buy it at
Amazon.co.uk

Jacques de Vaucanson, a French inventor, made his name in the 1730s by building a flute-playing automaton that (with the aid of a set of bellows) actually breathed. More famous still was his mechanical duck that ate its food and then defecated. After an unsuccessful attempt to apply his skills to automating the French weaving industry (the weavers of Lyons rioted when they heard about his plan to herd them into factories and have them perform like parts of a giant automaton), Vaucanson spent many years trying to build a medical automaton that could bleed. Another of his inventions, a loom driven by punch-cards, was subsequently perfected by Jacquard. It, in turn, helped to inspire Charles Babbage, the pioneer of a mechanical computer that one observer called a “thinking machine”.

Following in Vaucanson's footsteps, Wolfgang von Kempelen, a Hungarian nobleman, built two machines that imitated uniquely human capabilities: speech and reason. He constructed a speech synthesiser capable of uttering short, simple sentences, but was better known for his mechanical man, dressed in a Turkish costume and seated behind a wooden cabinet, that could play chess. The Turk, as it became known, toured the courts of Europe in the 1780s and prompted a debate, over 150 years before the first digital computers, about whether a machine could think. It was a hoax, of course, but nobody ever quite figured out how it worked. In the 1950s, scientists proposed chess-playing as a test of machine intelligence; Kempelen is thus remembered today both by computer scientists and magicians.

Thomas Edison, famed as the inventor of the light bulb and the phonograph, had less success with another of his inventions: a talking doll with a phonograph in its chest. Ms Wood contrasts the pitfalls of its development with a novel from the same period that describes Edison's ficticious construction of a perfect artificial woman. And she explains how a precursor of the movie camera was devised by a French scientist, Etienne-Jules Marey, to investigate human physiology by capturing and freezing phenomena (such as a beating heart) that were too fast for the eye to see, thus revealing the machine-like nature of the human body. Her survey of the extent to which machines can imitate life, and living things can be likened to machines, culminates in the touching story of a family of circus midgets who pretended to be dolls.

Ms Wood expertly highlights the many parallels and connections between all of these tales. She ends with a visit to a modern Japanese robotics laboratory, which brings the age-old obsession with creating mechanical life right up to date—but also demonstrates how little has changed since the days of Vaucanson.

Living Dolls: A Magical History of the Quest for Mechanical Life.
By Gaby Wood.
Faber and Faber; 278 pages; £12.99

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About sponsorship

New fiction

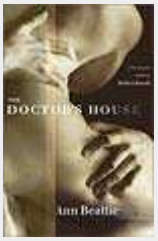
Screwed, blued and tattooed

Mar 7th 2002
From The Economist print edition

SINCE 1974, when her first short story appeared in the *New Yorker*, Ann Beattie has written some of the best fiction to have come out of the United States—wry, bittersweet, exquisitely observed and modest-toned. Even admirers of her work, though, are likely to find “The Doctor's House” heavy going. It is a brutal, deeply unpleasant story of parents and children, adultery and loss.

The story is told in three parts. First, there's Nina, a freelance copy editor in her 30s. Since her husband's early death in a car accident she has led a cloistered and self-protecting existence. Then Nina's mother relates how her miserable marriage to a philanderer, bully and coward—the doctor of the book's title—drove her to alcoholism. Finally, Nina's brother, Andrew, gives his version of family life. Like his father, he is a prolific womaniser, unable to see, let alone accept responsibility for, the emotional damage he causes. The picture that slowly develops, of three lives wrecked by a tyrannical husband and father, is not a pretty one.

The Doctor's House
By Ann Beattie



Scribner; 283 pages; $24

Buy it at
Amazon.com
Amazon.co.uk

Some will object that Ms Beattie's cause-and-effect approach is schematic and psychologically unsubtle. But it is horribly effective. Ms Beattie brings home the awfulness of what is, after all, often fairly predictable stuff—the consequences of adultery, of growing up confused and without affection, of not learning what it is to give and receive love. She conjures up a wholly believable world, cruel and unattractive as that world might be.

This is not, then, a book to relax with on the beach. “The Doctor's House” is grimly, bruisingly compelling.

The Doctor's House.
By Ann Beattie.
Scribner; 283 pages; $24

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About sponsorship

Musical lives

Modern master

Mar 7th 2002
From The Economist print edition

FOR many, Arnold Schoenberg remains the bogeyman of 20th-century music, a kind of impenetrable conundrum. Allen Shawn's new study is not a biography in the conventional sense, nor is it just an analysis of Schoenberg's music. Mr Shawn is a pianist, composer and professor of music who writes with an enthusiasm and affection for his subject that is immediately engrossing.

He believes that a large part of the problem with the way people view Schoenberg's work is that it needs to be explained and defended, rather than simply listened to. He has noticed that students whose interests are not limited to classical music but also take in the visual arts, drama and cinema tend to be more open to Schoenberg (and his followers) than those holding the still widespread prejudice that Schoenberg's music is "repellent or that it represents a wrong turn".

Arnold Schoenberg's Journey
By Allen Shawn

Farrar, Straus and Giroux; 272 pages; $26

Buy it at
Amazon.com
Amazon.co.uk

Schoenberg was born in Vienna in 1874 and died in Los Angeles in 1951. He worked within the musical academy throughout his career. In the 1920s he was in charge of the composition class at the Akademie der Künste in Berlin, and when he emigrated to America in the 1930s he became a professor at the University of California. Yet he was always perceived as an outsider and a bad influence. As late as 1945 he was turned down by the Guggenheim Foundation when he applied for a grant, although the American Academy of Arts and Letters eventually awarded him $1,000.

Mr Shawn divides Schoenberg's career into four periods. In the first (1897-1908), Schoenberg was still under the influence of Brahms. Between 1909 and 1913 he started to compose works without key signatures—without a tonal centre. There followed a long compositional silence, or as Mr Shawn puts it, an internal search, that was finally broken in 1921, when Schoenberg started to compose by elaborating on a given series of all 12 tones. This was the method which popularly defines his genius or marks him as a serial killer. This third phase, which lasted till 1932, produced an unfinished opera and the "Variations for Orchestra". Finally, in his American phase (1933-51) Schoenberg moved away from entirely 12-tone works towards what Mr Shawn calls a synthesis of an entire lifetime's preoccupations.

Like Gustav Mahler, whom he admired, Schoenberg abandoned the Jewish faith in his youth, only to re-embrace it and find in it the inspiration for many of his later works. It is shocking to read some of the anti-Semitic statements with which he had to contend in the 1890s. Like so many other German and Austrian Jews, he had no doubts about Hitler's intentions from the earliest days of the Nazi takeover. This, together with the fact that Schoenberg was short (less than five-foot-four), leads Mr Shawn into a consideration of the philosophical attitude that Schoenberg developed—"the ability to accomplish with force of personality what one cannot accomplish with brute strength."

Although Mr Shawn looks deep into Schoenberg's compositions, his book is so accessibly written, and with such a lightness of tone, that it will be a valuable help to anyone who wants to enter the sound world of this complex composer. It is only recently, Mr Shawn tells us, that Schoenberg's music has come to be fully and knowledgeably interpreted, in superb, natural performances. Without Schoenberg, he persuasively argues, our times would have lacked one of their "most eloquent and characteristic voices".

Arnold Schoenberg's Journey.
By Allen Shawn.
Farrar, Straus and Giroux; 272 pages; $26

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About sponsorship

Madame de Pompadour

Unchangingly good

Mar 7th 2002 | VERSAILLES
From The Economist print edition

An exhibition explores Madame de Pompadour's remarkable patronage of the arts

ON HIS deathbed, Louis XIV warned his heir that to avert financial ruin he should avoid two types of people: dancers and architects. Alas, these words were forgotten when Louis XV met Jeanne-Antoinette Poisson, the future Madame de Pompadour. Not only was this pretty *bourgeoise* one of the best dancers at Versailles, she also had a habit of collecting houses. From 1746, when she became the king's mistress, until her death in 1764 at the age of 43, she built or redecorated about 15 of them—each one adorned with vast quantities of one-of-a-kind furniture, paintings, sculpture and fine porcelain figurines.

With her brother, the Marquis de Marigny, whom the king put in charge of the nation's art and architecture, Madame de Pompadour presided over the flowering of the arts in mid-18th-century France. Her good taste did not come cheap, however, and she died virtually penniless, having spent a fortune on houses and on an art collection so vast that it took a year to inventory and eight months to sell.

However, at Versailles, which is staging the first exhibition devoted to Madame de Pompadour's patronage of the arts, we do not see enough of it. Most of her chateaux were destroyed during the French Revolution or remodelled afterwards. Even the Elysée palace, formerly her Hôtel d'Evreux, retains little she would recognise. Much of her silverware was melted down after her death and her chic dresses were given to her chambermaids. Nonetheless, it is disappointing that Versailles should have mounted such a lifeless show to celebrate a woman who excelled at the art of living. Their *à la lettre* policy of including only those objects proven to come from her houses, and their staging of the exhibition in cramped exhibition galleries, rather than in the palace's original Louis XV rooms, leaves visitors with little sense of the lavish ambience that is synonymous with her name.

The curators say that Madame de Pompadour's recently restored private apartments (which can be visited only by appointment) are too small to hold the exhibition and that no other authentic Pompadour rooms remain in the chateau. But who would visit Versailles to see a gallery wallpapered with computer facsimiles of designs for her interiors? Neither here nor in her apartments do we glimpse the woman's legendary talent for creating spaces that overflowed with novel styles, colours and materials, where courtiers mingled with philosophers to exchange ideas and gossip as she rouged her cheeks.

Nevertheless, several objects in the exhibition offer clues as to how this paramour became, in the king's words, “the most delicious woman in France” and rose to the rank of duchess. Her innumerable portraits speak volumes about how she used her wits to charm the king and insinuate herself into every aspect of his life. While her brother complained that none of them captured her likeness, they show her as one of the most stylish and cultivated women of her age. Most of them feature books by Voltaire, Buffon, Marivaux and others—writers whom she not only read but also commissioned. The architectural plans, sketches and furniture around her bespeak her patronage of the arts; the song sheets and plays are those she performed in amateur theatricals at court; the elaborate dresses are her own creations. Every detail attests to her eye, education and status as taste-maker extraordinary.

France's role as an arts-and-luxury goods capital did not begin with Madame de Pompadour, but she was its most energetic ambassador and put its porcelain industry on the map. She had unusual sympathy for artists' quirks and defended Voltaire even after he insulted her. “You have been unchangingly good to me,” he later wrote to her, “...furthermore I venture to thank you for all you have done to help a large number of writers, artists and other deserving people.”

Most of her real power began after she became the king's “amie”, rather than his “amour”, around 1750, when she reinvented herself as upright and respectable. To combat her reputation as a monument of impiety, she commissioned sugary religious pictures—although the inventory of her library (which listed

five books of religious sermons and 215 of philosophy) may reveal her true tastes. She sent her brother on a grand tour of Italy after the discoveries of Pompeii and Herculaneum, which resulted in the emergence of neo-classicism in France. Napoleon himself would later owe her a debt of gratitude: she sold her diamonds to endow the Ecole Militaire, which educated poor but noble boys like him.

Critics of the marquise (as she continued to call herself) derided her for abusing her influence with the king so as to corrupt national policy—a common complaint against partners of powerful men. Today, Madame de Pompadour's penchant for expensive art and ephemeral baubles may seem unedifying, her taste for Boucher's cupids at best a frivolous pleasure. But we should recall that in an age when she was expected to devote her life to leisure, she had the shrewdness and foresight to see that generous patronage of the arts would make her name immortal.

"Madame de Pompadour et les Arts" is at the Musée des Châteaux de Versailles et de Trianon until May 19th; then at the Kunsthalle, Munich (June 14th-September 15th) and the National Gallery, London (October 16th-January 3rd 2003).

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About sponsorship

Victor Posner

Mar 7th 2002
From The Economist print edition

Victor Posner, master of the hostile takeover, died on February 11th, aged 83

AP

IT WAS easy to be rude about Victor Posner. “Vulture” was one of the politer nouns applied to him. Mr Posner was a pioneer of the hostile takeover of a public company. He was dismissive of the convention previously observed that a takeover should have the agreement of the existing board. He would spot a company whose assets he judged were undervalued, gain control and milk it. Some bits would be sold off, others would be closed. Previously unconsidered treasures, such as the employees' pension fund, would be raided and reinvested in Mr Posner's other companies. As chief executive Mr Posner would draw a large salary. At one stage he controlled more than 40 companies said to be worth $4 billion and was reckoned to be one of the highest-paid men in the United States.

Worried companies fearing a Posner raid sought to stop him. This was not proper business, they said; it was more like undeclared war. They set up defences against the aggressor. “Golden parachutes” were promised to managers of threatened companies, potentially increasing the cost of a takeover. “Poison pills” were schemes to issue extra shares, again designed to make a takeover more expensive. A “sandbag” was a device to gain time in the hope that a more acceptable company, a ”white knight”, would try to take over. But against Mr Posner's blitzkrieg the defences were no more use than the Maginot line.

Mr Posner had his defenders. If you believe in a free market is it fair to vilify someone who is simply trying to make a living, albeit a good one, by making use of the system? Then again, many of his victims were said to be tired and underperforming. Mr Posner, it could be claimed, was having a healthy effect on the market. This surely was the entrepreneurial spirit that had helped to make America great. Regulation on the other hand was the Great Satan. Such opinions tended inevitably to be offered by those who took a detached view of the market rather than by those who had suffered its cruelty. All the same, as a result of Mr Posner's adventures and those of others who followed his lead in the era of modern takeovers, the market found itself caught in a moral maze of freedom and regulation that continues to be confusing.

Rudiments of business

The scourge of the boardrooms had no formal financial training. Victor Posner was the son of Russian immigrants. He left school at 13 and learnt the rudiments of business helping in his father's grocery shop in Baltimore. At the time of the Great Depression he somehow was able to borrow money to build low-cost housing, all that people could afford. He retained the leaseholds, bought others, and collected the ground rent. He was said to own around 20,000 leases, each bringing in a trickle of rent. By the mid-1950s, when Mr Posner was in his 30s, he was already rich and had settled in Miami, and was bored and wondering what to do next.

His first successful hostile bid was for a Detroit cigar maker that became his holding company. Mr Posner had rediscovered a financial instrument known as leverage, much used in the wild 1920s by financiers such as Ivar Kreuger (who shot himself when things went bad). The huge debts Mr Posner ran up to pay for his raids were backed by holdings in other companies he controlled. Soft-drink bottlers, fast-food chains, a steel company, an insurance company, one by one they fell into his shopping basket.

Mr Posner gained a reputation for being clever, creative, perhaps a financial genius. Kenneth Galbraith for one was scornful about such “genius”:

> That a certain diligence is required in financial transactions is not in doubt: the practitioners and their acolyte lawyers are known to work relentlessly. Needed also are at least an elementary knowledge of corporate accounting and the ability to digest and remember the information so revealed. Needed most of all is a relentless desire to accumulate money at whatever cost to reputation or personal liberty. But not much else.

Mr Posner nearly lost his liberty in 1987 for tax evasion, but a lenient court ordered him to give $3m to charities and serve meals to the homeless for eight weeks. He was in and out of civil courts pursued by irate shareholders who claimed mismanagement and other sins, but was generally well protected by lawyers. The Securities and Exchange Commission, the government body that watches over capital markets, was involved in some cases to do with takeovers but was wary of being seen to be too interfering. In 1994 Mr Posner was found guilty of concealing a fraudulent takeover scheme involving two other financiers, Michael Milken and Ivan Boesky. The judge said Victor Posner was “contemptuous of the interests of public shareholders” and barred him from serving on any public company. But by then he was close to retirement.

He professed not to care about his reputation, but like other owners of needless amounts of money he sought to be liked by giving some away. In future years anyone visiting the University of Miami may notice the imposing Victor Posner Centre for Communicative Disorders and wonder who the benefactor was. A good man, no doubt.

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Overview

Mar 7th 2002
From The Economist print edition

Data from **America's manufacturers** gave rise to some of the strongest hopes yet that the country's economy is emerging from recession. The Institute for Supply Management's (ISM) manufacturing index jumped from 49.9 in January to 54.7 in February, surging past analysts' expectations. Index levels below 50 indicate shrinking factory activity; readings above 50 signal a rise.

Britain's beleaguered manufacturers also brought long-awaited optimistic news. The Chartered Institute of Purchasing and Supply's purchasing managers index rose to 50.1 in February from 46.5 in January, in a possible sign that the country's “two-speed economy”, with manufacturers lagging behind the rest of the economy, may be performing more uniformly.

The **euro area's** purchasing managers index rose from 46.3 in January to 48.3 in February, though it still indicates an overall contraction. The index figures for **Italy**, **Greece** and **Ireland**, however, showed expansion.

Italy's GDP rose by 0.7% in the year to the fourth quarter.

Canada's economy grew by 0.9% in the year to the fourth quarter, but industrial production fell by 5.5% in the year to December.

Japanese workers suffered a 3.4% pay cut in the year to January.

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Output, demand and jobs

Mar 7th 2002
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate		
	1 qtr	1 year	2001	2002	latest		latest		latest		year ago
Australia	+ 5.2	+ 4.1 Q4	+ 2.2	+ 3.3	+ 0.4	Q3	+ 4.8	Q4	7.0	Jan	6.3
Austria	– 0.3	+ 0.9 Q3	+ 1.0	+ 1.0	– 3.3	Dec	– 1.4	Nov	3.7	Feb	3.4
Belgium	+ 0.1	+ 0.7 Q3	+ 1.1	+ 1.0	– 6.4	Dec	– 2.0	Dec	10.8	Feb*	10.6
Britain	+ 0.1	+ 1.7 Q4	+ 2.4	+ 1.9	– 4.6	Dec	+ 4.2	Jan	5.2	Dec†	5.3
Canada	+ 2.0	+ 0.9 Q4	+ 1.4	+ 1.4	– 5.5	Dec	+ 5.7	Dec	7.9	Jan	6.9
Denmark	+ 2.1	+ 0.9 Q4	+ 1.1	+ 1.3	– 6.3	Dec	+ 1.5	Dec	5.0	Dec	5.4
France	– 0.6	+ 0.9 Q4	+ 2.1	+ 1.4	– 1.7	Dec	– 0.6	Dec	9.0	Jan	8.9
Germany	– 1.0	– 0.1 Q4	+ 0.7	+ 0.7	– 5.1	Dec	– 4.1	Dec	9.6	Feb**	9.3
Italy	– 0.9	+ 0.7 Q4	+ 1.8	+ 1.1	– 4.1	Dec	– 0.8	Dec	9.3	Oct	10.0
Japan	– 2.1	– 0.5 Q3	– 0.4	– 1.3	–11.1	Jan	– 4.4	Dec	5.3	Jan	4.8
Netherlands	nil	+ 0.4 Q4	+ 0.9	+ 1.1	– 6.2	Dec	+ 1.2	Nov	1.9	Jan§	2.6
Spain	+ 0.7	+ 2.3 Q4	+ 2.6	+ 1.8	– 4.5	Dec	na		12.8	Jan	13.4
Sweden	+ 0.2	+ 0.4 Q3	+ 1.2	+ 1.4	+ 0.9	Dec	+ 1.0	Dec	4.4	Jan*	4.4
Switzerland	+ 0.1	+ 0.4 Q4	+ 1.4	+ 0.9	+ 1.9	Q3	+ 1.2	Dec	2.6	Jan*	2.0
United States	+ 1.4	+ 0.4 Q4	+ 1.1	+ 1.2	– 5.2	Jan	+ 5.4	Jan	5.6	Jan	4.2
Euro area	+ 0.4	+ 1.4 Q3	+ 1.5	+ 1.1	– 4.1	Dec	+ 0.4	Dec	8.4	Jan	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.8	– 0.9 Q4	na	na	– 3.1	Dec	+ 4.5	Nov	9.9	Jan*	9.9
Greece	na	+ 4.4 Q3	na	na	– 4.0	Dec	+ 4.1	Oct	na		na
Iceland	na	+ 3.62000	na	na	+ 2.5	2000	na		1.8	Dec	1.3
Ireland	na	+ 3.2 Q3	na	na	– 0.7	Dec	+ 9.1	Dec	4.2	Feb	3.6
Luxembourg	na	+ 8.52000	na	na	+ 6.1	Nov	+10.0	Oct	2.7	Dec	2.6
New Zealand	+ 2.8	+ 2.1 Q3	na	na	+ 2.6	Q3	+ 7.4	Q4	5.4	Q4	5.6
Norway	+ 1.0	+ 1.8 Q4	na	na	+ 1.2	Dec	+ 2.6	Jan	3.3	Q4	3.1
Portugal	– 1.0	+ 1.3 Q3	na	na	– 2.2	Dec	nil	Dec	4.1	Q4*	3.8

*Not seasonally adjusted. †Oct-Dec; claimant count rate 3.2% in Jan. §Nov-Jan. **EU harmonised rate 8.1% in Feb.

Text refers only to the first 16 countries listed

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Prices and wages

Mar 7th 2002
From The Economist print edition

% change at annual rate

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2001	2002	latest		year ago	latest		year ago
Australia	+ 3.1	Q4	+ 5.8	+ 4.1	+ 2.4	– 0.7	Q4	+ 8.4	+ 4.9	Q4	+ 5.4
Austria	+ 2.1	Jan	+ 2.8	+ 2.6	+ 1.5	– 0.4	Jan	+ 3.2	+ 2.7	Dec	+ 2.2
Belgium	+ 2.6	Feb	+ 2.3	+ 2.5	+ 1.5	– 2.6	Dec	+ 7.3	+ 3.1	Q4	+ 1.6
Britain	+ 1.3	Jan	+ 2.7	+ 1.9	+ 1.9	– 0.5	Jan	+ 1.7	+ 3.3	Dec	+ 4.4
Canada	+ 1.3	Jan	+ 3.0	+ 2.6	+ 1.2	– 1.2	Jan	+ 3.2	+ 3.5	Dec	+ 0.8
Denmark	+ 2.5	Jan	+ 2.3	+ 2.3	+ 1.8	+ 0.6	Jan	+ 4.1	+ 4.1	Q4	+ 3.8
France	+ 2.2	Jan	+ 1.2	+ 1.7	+ 1.1	– 1.2	Jan	+ 3.6	+ 4.1	Q3	+ 5.3
Germany	+ 1.7	Feb	+ 2.6	+ 2.4	+ 1.2	+ 0.2	Jan	+ 3.8	+ 2.2	Dec	+ 2.2
Italy	+ 2.5	Feb	+ 3.0	+ 2.5	+ 1.8	– 1.2	Jan	+ 5.4	+ 2.8	Dec	+ 1.7
Japan	– 1.4	Jan	– 0.3	– 0.7	– 0.9	– 0.6	Jan	+ 1.1	– 3.4	Jan	+ 0.2
Netherlands	+ 4.0	Jan	+ 4.2	+ 4.8	+ 2.4	– 2.2	Dec	+ 7.6	+ 4.6	Nov	+ 3.3
Spain	+ 3.1	Jan	+ 3.7	+ 3.6	+ 2.3	+ 0.1	Jan	+ 3.9	+ 3.6	Q3	na
Sweden	+ 2.9	Jan	+ 1.7	+ 2.6	+ 2.0	– 0.5	Jan	+ 3.0	+ 3.0	Nov	+ 2.2
Switzerland	+ 0.7	Feb	+ 0.8	+ 1.0	+ 0.6	– 1.4	Jan	+ 1.4	+ 1.3	2000	+ 0.3
United States	+ 1.1	Jan	+ 3.7	+ 2.9	+ 1.4	– 2.6	Jan	+ 4.8	+ 4.0	Jan	+ 3.9
Euro area	+ 2.7	Jan	+ 2.4	+ 2.6	+ 1.5	– 0.9	Jan	+ 4.8	+ 2.9	Q3	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 2.3	Jan	+ 3.0	na	na	– 1.3	Jan	+ 4.5	+ 4.3	Q4	+ 5.0
Greece	+ 4.4	Jan	+ 3.4	na	na	+ 2.4	Dec	+ 6.7	na		na
Iceland	+ 8.9	Feb	+ 4.1	na	na	+ 9.6	Feb	+ 5.3	+10.0	Jan	+ 9.3
Ireland	+ 4.9	Jan	+ 5.2	na	na	nil	Dec	+ 4.5	+ 8.7	Q3	+ 7.4
Luxembourg	+ 2.3	Jan	+ 2.9	na	na	– 2.1	Dec	+ 5.0	+ 3.4	Aug	+ 7.0
New Zealand	+ 1.7	Q4	+ 4.0	na	na	+ 1.8	Q4	+10.7	+ 2.2	Q4	+ 1.6
Norway	+ 1.3	Jan	+ 3.4	na	na	– 8.2	Jan	+ 3.3	+ 4.6	Q3	+ 4.2
Portugal	+ 3.5	Jan	+ 4.4	na	na	– 6.1	Jan	+ 7.3	+ 2.4	Apr	na

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Economic forecasts

Mar 7th 2002
From The Economist print edition

Each month *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and the euro area. The table also shows their highest and lowest projections for growth. The previous month's forecasts, where different, are shown in brackets. Our panel has raised (again) its average forecast for America's GDP growth in 2002 from 1.2% to 1.7%; in January it was forecasting only 0.7%. Most other countries' growth estimates have edged up in concert with America. The panel has also become a little less gloomy about Japan, whose economy is now expected to shrink by 1.2%. The euro area is forecast to grow by 1.2% in 2002, a little higher than last month's forecast. This month, for the first time, we show forecasts for 2003.

March averages (previous month's, if changed)

	Real GDP, % change				Consumer prices		Current account	
	Low/high range		average		% increase		% of GDP	
	2002	2003	2002	2003	2002	2003	2002	2003
Australia	2.8/4.1	3.1/4.3	3.4 (3.3)	3.7	2.5 (2.4)	2.3	–3.2(–2.9)	–3.3
Austria	0.7/1.5	1.8/3.3	1.1 (1.0)	2.4	1.6 (1.5)	1.7	–2.1(–2.0)	–1.9
Belgium	0.5/1.5	1.9/3.5	1.1 (1.0)	2.9	1.6 (1.5)	1.6	4.6 (4.3)	4.5
Britain	1.5/2.4	1.9/3.6	1.9	2.9	2.0 (1.9)	2.4	–2.0(–2.1)	–2.1
Canada	0.8/2.5	3.0/4.9	1.7 (1.4)	3.7	1.2	1.9	2.1 (1.9)	2.2
Denmark	0.6/1.9	1.7/3.0	1.4 (1.3)	2.3	1.8	2.0	2.4 (2.3)	2.3
France	0.9/1.8	2.3/3.5	1.4	2.9	1.2 (1.1)	1.3	1.7 (1.5)	1.7
Germany	0.4/1.1	1.7/3.7	0.7	2.5	1.3 (1.2)	1.4	0.1(–0.1)	0.2
Italy	0.9/1.8	2.0/3.6	1.2 (1.1)	2.8	1.8	1.8	0.2	nil
Japan	–2.3/–0.2	0.3/2.0	–1.2 (–1.3)	1.1	–1.0 (–0.9)	–0.5	2.3 (2.2)	2.3
Netherlands	0.8/1.8	2.0/3.8	1.2 (1.1)	2.9	2.7 (2.4)	2.3	3.7	4.0
Spain	1.5/2.6	2.5/4.0	1.9 (1.8)	3.2	2.3	2.4	–2.2(–2.3)	–1.9
Sweden	0.9/1.8	1.2/3.4	1.4	2.8	2.0	2.0	2.4 (2.5)	2.5
Switzerland	0.3/1.9	0.8/3.0	1.0 (0.9)	2.0	0.6	0.9	10.1	10.1
United States	0.9/2.7	2.6/4.3	1.7 (1.2)	3.6	1.3 (1.4)	2.1	–4.1	–4.3
Euro area	0.9/1.5	2.1/3.7	1.2 (1.1)	2.8	1.6 (1.5)	1.6	0.2 nil	0.2

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan Chase, Morgan Stanley Dean Witter, Nordbanken, Decision Economics, Royal Bank of Canada, Schroder Salomon Smith Barney,

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Money and interest rates

Mar 7th 2002
From The Economist print edition

Money and interest rates

	Money supply* % change on year ago			Interest rates % p.a. (Mar 6th 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+21.6	+14.7	Jan	4.33	5.35	4.89	6.12	5.18	6.98
Britain	+ 7.9	+ 6.0	Jan	4.00	5.55	4.75	5.15	4.77	6.28
Canada	+17.7	+ 5.1	Jan	2.07	4.74	3.47	5.55	5.30	6.87
Denmark	+ 6.8	+ 8.7	Jan	3.70	5.27	4.39	5.28	5.00	7.09
Japan	+16.0	+ 3.6	Jan	0.07	0.14	0.10	1.47	1.13	1.62
Sweden	+ 7.1	+ 6.2	Nov	4.03	3.95	4.95	5.52	4.75	5.68
Switzerland	+ 4.1	+ 5.0	Jan	1.77	3.45	2.59	3.58	3.35	4.68
United States	+ 7.8	+11.3	Jan	1.81	4.93	3.22	5.04	4.77	6.84
Euro area†	+ 6.6	+ 7.9	Jan	3.37	4.70	3.97	5.09	4.69	5.74

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.54%, Japan No.237 1.47%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Mar 7th 2002
From The Economist print edition

1995=100

	Feb 26th	Mar 5th*	% change on one month	% change on one year
Dollar index				
All items	67.9	68.9	+ 2.8	– 4.1
Food	68.2	69.1	+ 2.1	– 3.2
Industrials				
All	67.5	68.6	+ 3.8	– 5.3
Nfa†	67.5	67.6	+ 6.2	+ 4.7
Metals	67.4	69.5	+ 1.9	–12.2
Sterling index				
All items	75.1	76.5	+ 2.6	– 1.0
Euro index				
All items	102.8	104.2	+ 2.7	+ 2.6
Yen index				
All items	97.0	96.9	+ 1.5	+ 6.6
Gold				
$ per oz	295.90	298.20	+ 2.1	+14.3
West Texas Intermediate				
$ per barrel	21.55	23.28	+15.8	–18.3

* Provisional. † Non-food agriculturals.

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Stockmarkets

Mar 7th 2002
From The Economist print edition

Market indices

		2002		% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
	Mar 6th	high	low				
Australia (All Ordinaries)	3,396.5	3,424.4	3,331.2	+ 1.1	– 0.8	+ 1.1	+ 2.7
Austria (ATX)	1,228.9	1,242.6	1,114.4	– 0.2	–29.3	+ 7.8	+ 5.2
Belgium (Bel 20)	2,739.3	2,811.1	2,622.4	+ 0.3	–25.6	– 1.5	– 3.9
Britain (FTSE 100)	5,245.5	5,323.8	5,024.1	+ 1.3	–24.3	+ 0.5	– 1.9
Canada (Toronto Composite)	7,944.3	7,944.3	7,418.1	+ 3.9	–30.2	+ 3.3	+ 3.7
Denmark (KBX)	226.6	229.3	216.8	– 1.0	–24.9	+ 0.8	– 1.6
France (SBF 250)	3,003.6	3,028.4	2,782.5	+ 3.6	–31.6	+ 0.7	– 1.7
(CAC 40)	4,588.1	4,682.8	4,239.0	+ 3.7	–33.7	– 0.8	– 3.2
Germany (Xetra DAX)	5,285.3	5,318.7	4,745.6	+ 6.6	–34.5	+ 2.4	– 0.1
Italy (BCI)	1,464.9	1,464.9	1,344.9	+ 4.9	–32.9	+ 2.2	– 0.3
Japan (Nikkei 225)	11,358.5	11,450.2	9,420.9	+ 7.4	–70.8	+ 7.7	+ 6.7
(Topix)	1,073.4	1,080.7	922.5	+ 6.6	–62.8	+ 4.0	+ 3.0
Netherlands (AEX)	513.1	513.1	478.3	+ 4.2	–26.9	+ 1.3	– 1.2
Spain (Madrid SE)	829.2	838.0	773.2	+ 2.2	–27.7	+ 0.6	– 1.9
Sweden (Affarsvarlden Gen)	227.8	236.8	209.9	+ 3.7	–43.1	– 1.6	– 0.8
Switzerland (Swiss Market)	6,416.3	6,440.7	6,105.2	+ 1.5	–23.7	– 0.0	– 2.3
United States (DJIA)	10,574.3	10,586.8	9,618.2	+ 4.4	– 9.8	+ 5.5	+ 5.5
(S&P 500)	1,162.8	1,172.5	1,080.2	+ 4.8	–23.9	+ 1.3	+ 1.3
(Nasdaq Comp)	1,890.4	2,059.4	1,716.2	+ 7.9	–62.6	– 3.1	– 3.1
Europe (FTSE Eurotop 300)*	1,259.5	1,271.9	1,185.5	+ 2.5	–26.1	– 0.1	– 2.5
Euro area (FTSE Ebloc 100)*	1,106.5	1,121.6	1,013.0	+ 4.3	–28.6	– 0.5	– 2.9
World (MSCI)†	1,011.2	1,023.5	937.0	+ 5.0	–30.2	na	+ 0.8
World bond market (Salomon)‡	436.6	443.1	430.3	+ 0.8	– 5.1	na	– 0.7

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Mar 7th 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2002	2003	Exchange rate trade-weighted† Mar 6th	year ago	Currency units per $ Mar 6th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2001‡
Australia	+ 2.1	Jan	– 9.2	Q4	– 3.2	– 3.3	74.7	70.0	1.92	1.96	2.73	1.67	1.45	0.1
Austria	– 4.7	Nov	– 3.6	Dec	– 2.1	– 1.9	100.0	100.7	1.15§	1.08	1.64	–	0.87	nil
Belgium	+ 10.9	Dec	+ 12.4	Sep	+ 4.6	+ 4.5	98.7	99.5	1.15§	1.08	1.64	–	0.87	nil
Britain	– 48.4	Dec	– 17.7	Q3	– 2.0	– 2.1	106.6	104.5	0.70	0.68	–	0.61	0.53	1.1
Canada	+ 41.3	Dec	+ 18.9	Q4	+ 2.1	+ 2.2	76.3	77.2	1.59	1.55	2.26	1.38	1.20	2.8
Denmark	+ 6.8	Dec	+ 4.1	Dec	+ 2.4	+ 2.3	101.7	102.3	8.55	8.04	12.1	7.43	6.47	2.0
France	+ 2.9	Dec	+ 26.8	Dec	+ 1.7	+ 1.7	101.3	102.3	1.15§	1.08	1.64	–	0.87	-1.5
Germany	+ 84.0	Dec	+ 10.2	Dec	+ 0.1	+ 0.2	98.3	99.4	1.15§	1.08	1.64	–	0.87	-2.5
Italy	+ 8.7	Dec	+ 1.9	Nov	+ 0.2	nil	72.3	73.0	1.15§	1.08	1.64	–	0.87	-1.4
Japan	+ 70.2	Dec	+ 91.2	Dec	+ 2.3	+ 2.3	129.8	138.8	132	120	188	115	–	-6.4
Netherlands	+ 21.4	Dec	+ 11.8	Q4	+ 3.7	+ 4.0	97.6	98.5	1.15§	1.08	1.64	–	0.87	1.1
Spain	– 38.4	Nov	– 15.5	Nov	– 2.2	– 1.9	74.0	74.6	1.15§	1.08	1.64	–	0.87	nil
Sweden	+ 12.9	Jan	+ 5.9	Dec	+ 2.4	+ 2.5	77.0	78.1	10.41	9.74	14.8	9.04	7.87	3.8
Switzerland	+ 1.6	Jan	+ 25.4	Q3	+10.1	+10.1	111.6	107.8	1.70	1.66	2.41	1.48	1.28	na
United States	–426.6	Dec	–430.7	Q3	– 4.1	– 4.3	122.8	116.4	–	–	1.42	0.87	0.76	0.6
Euro area	+ 43.4	Dec	– 15.6	Dec	+ 0.2	+ 0.2	78.1	80.3	1.15	1.08	1.64	–	0.87	-1.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 11.1	Dec	+ 8.3	Dec	na	na	77.7	78.6	1.16§	1.08	1.65	–	0.88	3.7
Greece	– 19.3	Oct**	– 8.2	Oct	na	na	57.3	57.7	1.16	1.08	1.65	–	0.88	0.2
Iceland	nil	Jan	– 0.7	Q3	na	na	na	na	101	86	143	87.7	76.4	-0.2
Ireland	+ 31.4	Dec	– 1.2	Q3	na	na	86.9	88.5	1.16§	1.08	1.65	–	0.88	3.2
Luxembourg	– 2.8	Nov	+ 0.4	Q3	na	na	98.7	99.5	1.16§	1.08	1.65	–	0.88	5.3
New Zealand	+ 0.3	Jan	– 0.2	Q3	na	na	83.2	79.8	2.39	2.35	3.39	2.08	1.81	1.3
Norway	+ 24.5	Jan	+ 23.8	Dec	na	na	98.7	93.6	8.92	8.86	12.7	7.75	6.74	14.3
Portugal	– 14.0	Nov	– 10.5	Dec	na	na	89.0	89.8	1.16§	1.08	1.65	–	0.88	-1.7

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate. §Now using euro only. **Corrected.

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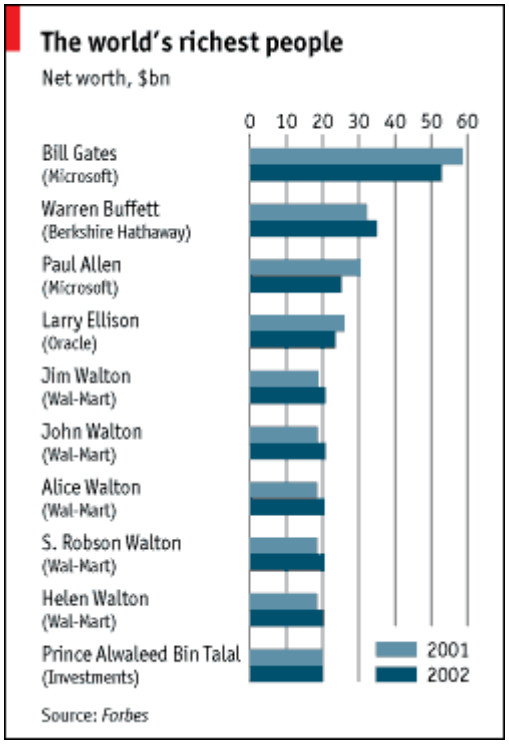
The world's richest people

Mar 7th 2002
From The Economist print edition



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Overview

Mar 7th 2002
From The Economist print edition

Emerging economies continued to feel the effects of the global economic slowdown. **Brazil's** GDP fell by 0.7%, and **Hong Kong's** by 1.6%, in the year to the fourth quarter.

Taiwan's economy may be picking up thanks to a surge in manufacturing; industrial output rose by 12.0% in the year to January.

Inflation is bedevilling a number of poor countries. In the year to February, consumer prices rose by 6.7% in **Colombia**, by 13.7% in **Venezuela**, by 15.1% in **Indonesia** and by 17.9% in **Russia**.

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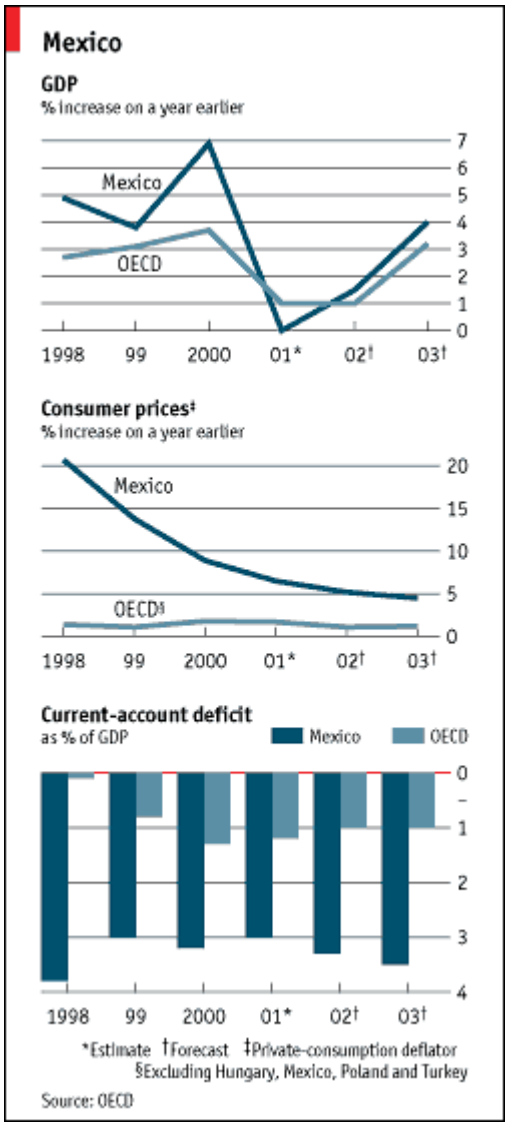
Mexico

Mar 7th 2002
From The Economist print edition

After five years of solid growth, the Mexican economy slowed sharply last year. But for the first time in the country's recent history, that slowdown was caused by the knock-on effects of America's slowing economy rather than domestic macroeconomic mishaps. As America's economy recovers in 2002, so too should Mexico's. In its latest country report, the OECD forecasts modest GDP growth of 1.5% in 2002, followed by a robust 4% in 2003. Consumer prices are expected to rise by barely 5% in 2002.



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Economy

Mar 7th 2002
From The Economist print edition

	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 6.3	Q4	+ 9.9	Jan	– 1.0	Jan	+24.1	Jan	+20.5	2000	211.8	Nov
Hong Kong	– 1.6	Q4	– 7.1	Q3	– 3.5	Jan	–11.8	Jan	+ 8.9	Q3	111.3	Jan
India	+ 5.3	Q3	+ 1.6	Dec	+ 4.9	Jan	– 5.5	Jan	– 0.7	Q3	46.4	Jan
Indonesia	+ 4.1	Q4	+ 2.0	Q2	+15.1	Feb	+25.4	Jan	+ 3.8	Q3	27.0	Jan
Malaysia	– 0.5	Q4	– 7.7	Dec	+ 1.1	Jan	+14.5	Jan	+ 7.4	Q3	30.5	Dec
Philippines	+ 3.8	Q4	–11.3	Dec‡	+ 3.4	Feb	+ 2.6	Dec	+ 4.9	Nov	14.0	Jan
Singapore	– 7.0	Q4	+ 4.7	Jan	– 1.1	Jan	+ 5.7	Jan	+17.9	Q4	75.3	Jan
South Korea	+ 1.8	Q3	+10.2	Jan	+ 2.6	Feb	+ 9.4	Feb	+ 8.6	Dec	104.3	Jan
Taiwan	– 2.7	Q4	+12.0	Jan	+ 1.4	Feb	+17.9	Feb	+19.0	Q4	123.6	Jan
Thailand	+ 1.5	Q3	+ 1.3	Dec	+ 0.3	Feb	+ 2.6	Jan	+ 6.3	Jan	33.1	Jan
Argentina	– 4.9	Q3	–17.2	Jan	+ 4.0	Feb	+ 7.2	Jan	– 6.8	Q3	14.6	Dec
Brazil	– 0.7	Q4	– 6.1	Dec	+ 9.8	Jan	+ 3.5	Feb	–22.1	Jan	36.2	Jan
Chile	+ 2.6	Q3	+ 4.5	Jan	+ 2.5	Feb	+ 1.3	Jan	– 0.9	Q4	14.1	Jan
Colombia	+ 1.0	Q3	– 1.4	Dec	+ 6.7	Feb	+ 0.3	Dec	– 1.2	Q3	10.1	Jan
Mexico	– 1.6	Q4	– 3.6	Dec	+ 4.8	Jan	– 9.5	Jan	–17.1	Q4	47.2	Jan
Peru	+ 3.9	Jan	– 2.1	Dec	– 1.1	Feb	– 0.1	Dec	– 1.1	Q4	8.4	Jan
Venezuela	+ 2.8	Q3	+ 7.9	Oct	+13.7	Feb	+13.0	Q3	+ 4.4	Q4	9.2	Dec
Egypt	+ 4.6	2000†	+ 9.4	2000†	+ 2.2	Nov	– 8.5	Sep	nil	Q3	13.3	Nov
Israel	– 3.4	Q4	– 8.5	Dec	+ 3.1	Jan	– 7.0	Jan	– 3.6	Q3	24.2	Feb
South Africa	+ 1.8	Q4	+ 5.4	Dec	+ 5.0	Jan	+ 3.7	Jan	+ 0.3	Q3	6.0	Jan
Turkey	– 7.1	Q3	– 9.4	Dec	+73.1	Feb	– 9.3	Dec	+ 2.8	Nov	19.1	Jan
Czech Republic	+ 3.2	Q3	+ 7.0	Dec	+ 3.7	Jan	– 3.1	Jan	– 2.6	Q3	14.5	Jan
Hungary	+ 3.3	Q4	– 1.6	Jan	+ 6.6	Jan	– 2.2	Jan	– 1.7	Jan	10.3	Jan
Poland	+ 0.8	Q3	– 1.4	Jan	+ 3.5	Jan	–11.3	Jan	– 6.9	Jan	25.4	Jan
Russia	+ 4.9	Q3	+ 2.2	Jan	+17.9	Feb	+49.7	Dec	+41.5	Q3	32.3	Jan
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*												
Pakistan	+ 3.3	2001†	+ 7.7	Sep	+ 2.5	Jan	– 1.0	Nov	+ 0.3	2001†	3.6	Jan
Saudi Arabia	+ 4.5	2000	na		nil	Nov	+50.9	2000	+14.3	2000	17.6	Jan

*Excluding gold, except Singapore; IMF definition. ‡New series. †Year ending June.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Mar 7th 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Mar 6th		Dec 31st 2001	
	Mar 6th	year ago	Mar 6th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	11.8	na	1,636.4	+2.0	– 4.4	– 4.4
Hong Kong	7.80	7.80	11.1	2.01	11,003.0	+3.3	– 3.5	– 3.5
India	48.7	46.5	69.1	6.22	3,614.4	–2.5	+ 10.8	+ 9.8
Indonesia	9,955	9,875	14,141	17.51	477.0	+4.9	+ 21.7	+ 27.1
Malaysia	3.80	3.80	5.40	3.28	737.1	+4.7	+ 5.9	+ 5.9
Philippines	51.1	48.1	72.6	7.31	1,418.5	+1.1	+ 21.4	+ 22.6
Singapore	1.82	1.76	2.59	1.00	1,799.6	+5.7	+ 10.8	+ 12.2
South Korea	1,311	1,270	1,863	4.46	843.1	+2.5	+ 21.5	+ 21.7
Taiwan	35.0	32.4	49.7	2.55	6,097.6	+7.0	+ 9.8	+ 9.9
Thailand	43.5	43.7	61.8	2.31	391.7	+5.2	+ 28.9	+ 31.0
Argentina	2.07**	1.00	2.93	na	382.9	+0.8	+ 29.6	– 37.2
Brazil	2.35	2.05	3.34	18.80	13,823.7	–2.5	+ 1.8	+ 0.1
Chile	667	587	948	3.50*	5,422.6	+2.8	+ 0.5	– 0.4
Colombia	2,288	2,263	3,250	10.67	1,077.8	–0.9	na	na
Mexico	9.07	9.66	12.9	6.97	7,154.1	+5.3	+ 12.3	+ 13.4
Peru	3.46	3.51	4.91	2.97	1,302.9	+1.4	+ 10.9	+ 10.4
Venezuela	981	705	1,393	38.09	6,938.2	–1.6	+ 5.6	– 18.4
Egypt	4.64	3.88	6.59	7.23	5,390.8	+2.6	+ 2.2	+ 0.8
Israel	4.72	4.12	6.70	2.83	396.1	–4.1	– 11.3	– 17.1
South Africa	11.0	7.89	15.7	10.38	10,873.6	–0.7	+ 4.1	+ 13.3
Turkey	1,372,500	905,000	1,949,636	52.00	11,346.7	+1.4	– 17.7	– 12.7
Czech Republic	36.0	37.5	51.1	4.30	424.9	+1.7	+ 7.7	+ 6.5
Hungary	279	287	396	8.41	8,277.7	+4.2	+ 16.1	+ 14.5
Poland	4.15	3.96	5.90	10.05	15,307.6	nil	+ 10.0	+ 4.7
Russia	31.1	28.7	44.1	25.00	319.3†	+9.5	+ 25.0	+ 22.8
EMF (MSCI)‡	1.00	1.00	1.42	na	347.8	+3.8	na	+ 9.6
EMBI+§	1.00	1.00	1.42	na	213.7	+0.5	na	+ 6.7

*Inflation adjusted. †In $ terms. ‡Emerging Mkts Free. §J.P. Morgan Chase's Emerging Mkts Bond Index Plus. **Fixed official rate 1.40.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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